APPENDIX A

Opinions of the Court of Appeals

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 21089

FRANK ROSS,

Appellant,

—versus—

F. E. STANLEY, ET AL,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF FLORIDA.

(June 1, 1965)

Before TUTTLE, Chief Judge, RIVES, Circuit Judge, and SIMPSON, District Judge.

TUTTLE, Chief Judge: This is an appeal from an order of the district court dismissing this shareholder's derivative action which the trial court considered to have alleged two separate claims, one for damages and the other for unjust enrichment. The court dismissed the former claim

on the ground that it was barred by the Florida three-year statute of limitations[1] and its dismissed the latter claim on the ground that it was prematurely in Court. Whether or not this conceptual bisection of the complaint is too finical a refinement, it can avail the appellant nothing. Regardless of the number of claims which may have been stated, we hold that the entire lawsuit is barred by the statute of limitations.

The complaint, while long and involved, because of the number of parties and the relationships of the several parties, stated the following relatively simple situation: Ross had been a stockholder of Florida Gas Company (FGC), a Florida corporation, since August 21, 1958. Florida Gas Transmission Company (Transmission), a Delaware corporation, is Florida Gas Company's wholly-owned subsidiary. The two companies and their eight directors individually were joined as defendants with three construction companies and one engineering company, which had performed substantial work in connection with the construction of Transmission's gas pipeline from Texas to Florida. Plans for the construction of Transmission's pipeline began around 1952, with various of the individual and corporate defendants (and the latter's predecessors) in on the early planning. The plan contemplated construction work to be performed by the three defendant construction companies and engineering work by the defendant engineering company. There was to be no competitive bidding on the construction or engineering contracts, but they were to be executed "on terms anal-

[1] Fla. Stat. § 95.11 (5).

ogous to but incorporating a cost no higher than an arm's length contract for similar work under similar circumstances." The persons in control of the defendant contracting companies, it was alleged, were and are still also in control of FGC, Transmission, and their corporate predecessors. Therefore, it was alleged that the contracts in question were subject to the Federal Power Commission's "no profits to affiliates" rule, under which the FPC excludes from a regulated company's rate base the amount of a claimed cost item which represents profits made by an "affiliate." The contracts between the gas companies and their "affiliates" were entered into in November, 1958. It was alleged that these contracts contemplated a substantial profit to the "affiliates" which the defendants knew or ought to have known would be disallowed by the FPC in determining the proper rate base to be used by FGC in fixing the rates for the ultimate sale of its gas. Thus, it was alleged, the defendants knowingly entered into contracts with themselves or their associates which resulted in approximately $10,000,000 of profits to the affiliated group all of which, as they knew or should have known, would be disallowed from the rate base and thus be lost as an asset to Florida Gas Company.

Since the question of accrual depends on the nature of the claim or claims forming the basis of the complaint, we copy the language of the complaint asserting the claim:

> "31. Defendants and the other developers and directors of Transmission and Florida Gas breached their fiduciary duties to Transmission or Florida Gas as follows:

(a) The manner of appointment and the membership of Transmission's negotiating committees . . . were such as to foreclose arm's length negotiation of the contracts between Transmission and the contracting firms.

(b) By reason of the absence of arm's length negotiation of such contracts and by reason of the matters alleged . . . [previously], and during the period referred to . . . [previously], each of the contracting firms was an affiliate of Transmission within the purview of the FPC's 'no profit to affiliates' rule, as defendants and the other developers and directors of Transmission and Florida Gas knew or should have known.

(c) To the knowledge or notice of defendants and the other developers and directors of Transmission and Florida Gas, such affiliation of the contracting firms with Transmission exposed Transmission and Florida Gas to the danger that the FPC might eliminate from Transmission's rate base so much of the cost of the pipeline as reflects the profits of the contracting firms.

(d) Defendants and the other developers and directors of Transmission and Florida Gas could and should have avoided such danger by causing Transmission to award the contracts to firms not affiliated with Transmission, or by awarding the contracts to the contracting firms at cost.

(e) Defendants and the other developers and directors of Transmission and Florida Gas caused Transmission to award the contracts to the contracting firms pursuant to their aforementioned plan and scheme and in order to give the contracting firms an

opportunity to profit, regardless of the foreseeable injury to Transmission and Florida Gas.

(f) By reason of the acts of defendants and the other developers and directors of Transmission and Florida Gas, said companies have been injured or damaged, and may or will suffer further injury and damage, as alleged in paragraph 15, supra.

(g) Each of the contracting firms, including its stockholders, has been unjustly enriched by so much of the payments received by it as constitutes a profit to it.

32. (a) Defendants are jointly and severally liable to Transmission and Florida Gas for the profits realized by each of them and for the damages sustained and to be sustained by Transmission and Florida Gas.

(b) The determination of the amounts of defendants' profits and of the damages sustained and to be sustained by Transmission and Florida Gas requires an accounting by defendants."

The complaint alleged that the staff of the Federal Power Commission had, at the time the complaint was filed, raised the issue but at that time the Commission had not made its determination as to how much, if any, of the profits of these contracting companies were comprehended within the "no profits to affiliates" rule and, therefore, how much, if any, of the alleged profits would ultimately be disallowed. The complaint alleged that this entitled the plaintiff to an accounting for such amounts as were ultimately determined by the Federal Power Commission not to be allowable as part of the "actual legitimate cost" of

the transmission lines[2] under its rule prohibiting the inclusion in the cost of facilities of any "inter-company profits."[3] The complaint ended with the stock assertion that "plaintiff has no adequate remedy at law."

Each of the appellees filed a motion to dismiss the complaint under Rule 12(b)(6), of the Federal Rules of Civil Procedure for failure to state a claim upon which relief could be granted. Some of them also filed specific pleas of limitation by the Florida three-year statute of limitations, and of laches. The court considered that the Rule 12(b)(6) motion sufficiently raised the defense of the statute of limitations as to all appellees. The trial court expressly ruled, and the parties both concede in this Court, that the Florida three-year statute of limitations is available as a defense if it applies under the pleaded facts.

All parties seem to agree that "limitation never commences to run until the time when the plaintiff could first have maintained his action to a successful result." *Brownell* v. *City of St. Petersburg,* 5 Cir., 1942, 128 F. 2d 721, 724. The appellees argue that an action for nominal damages or for rescission of the contract could have been maintained in November, 1958. The appellant denies the possibility of a suit for nominal damages and argues that

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[2] Sec. 6 of the Natural Gas Act, 15 U.S.C.A. § 717(e) provides that "the Commission may investigate and ascertain the actual legitimate cost of the property of every natural gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property."

[3] For an application of the Commission's rule see St. Croix Falls, Minnesota Improvement Company, et al, Proceedings re Reclassification of Electric Plant Accounts of Public Utilities, 3 F.P.C. 13.

the maintainability of a rescission action is immaterial since that would be a different "claim" from the one presented here. We find no need to resolve this debate, because a careful reading of the complaint reveals that substantially the same complaint, asserting in essence the same claim, or claims, could have been filed by the appellant and maintained "to a successful result" as early as November, 1958.

In the section of his brief arguing that his complaint states a claim upon which relief could be granted, the appellant states that "it would be within the allegations of the complaint . . . to adduce proof of a conversation among all defendants, at which one of them stated, and the others agreed to, these propositions:

> "'We know that the contracting firms are affiliates of Transmission and FGC. We know that their contracts have not been negotiated at arm's length. We know that the payments they will receive from Transmission are likely to yield substantial profits to them. We know that these profits will not be part of the "actual legitimate cost" of Transmission's pipeline properties. We know that the FPC will disallow the profit from Transmission's rate base. We know that this will cause great harm to Transmission and FGC; but we do not care about this injury, because we want the contracting firms to make a profit, according to our original plan and scheme.'"

From this, appellant concludes that "a constructively fraudulent breach by defendants of their fiduciary duties" is alleged. Alternatively, the appellant construes his complaint as charging that the appellees "acted negligently in

awarding the construction and engineering contracts to the contracting firms and thereby caused a loss to Transmission and to FGC."

If these statements accurately describe the gravamen of the appellant's complaint, there is no reason why such a complaint could not have been brought in November, 1958, when the contracts were executed, or within three years thereafter. There is no charge of any concealment on the part of the appellees, and it is clear from the record that no such charge would be justified. Only if some new transaction or occurrence, cited in the complaint and material to the appellant's claim for relief, took place within three years before the filing of the complaint, can it be said that the present action is different from one which first could have been maintained to a successful result in November, 1958. The appellant seeks to supply this more recent element in his brief and oral argument and, somewhat incidentally, in his complaint by making action by the FPC "essential" to his prayer for relief. The part of the appellant's complaint which could not have been included in a complaint filed in November, 1958, in paragraph 15. This alleges that the FPC's staff has recommended elimination of the affiliates profits from Transmission's rate base and that, on June 8, 1962, the FPC approved a stipulation between its staff and the gas companies which "fixed the rates chargeable by Transmission on the basis of eliminating from its rate base those cost items which the staff of the FPC contends should be eliminated . . . without prejudice to the ultimate cost determination to be made by the FPC. . . ."

Because of these allegations, the appellant contends that his claim for damages could not have accrued prior to June 8, 1962.

But the recommendations of the FPC's staff and the approval of the stipulated temporary rate base add nothing of substance to the appellant's basic claim for relief. Even in paragraph 15, the appellant finds it necessary to allege:

> "If the FPC ultimately eliminates from Transmission's rate base all or part of the cost items reflecting the profits of the contracting firms, Transmission's pipeline investment will be lost to the extent of the cost items so eliminated from its rate base, to Transmission's great injury and damage."

This same allegation of impending, and foreseeable, future injuries stemming from the breach of fiduciary duty consummated in November, 1958, goes to the heart of appellant's claim and, like substantially all the rest of the complaint, could have formed part of an action commenced more than three years before the filing of the present suit.

The circumstances alleged to have existed at the time the contracts were executed in November, 1958, unquestionably would have supported a bill in equity for an accounting based on a breach of the fiduciary relationship resulting in injury, the damages from which could not be computed until a later date. Such an action for accounting from allegedly faithless fiduciaries is fully recognized in Florida. *R. O. Holton & Co.* v. *Hull*, 1939, 140 Fla. 687, 192 So. 229. In *Royal Indemnity Co.* v. *Knott, Fla.* 1931, 136 So. 474, 478, the Supreme Court of Florida said "and it may be said generally that whenever there is a fiduci-

ary relation such as that of trustee, agent, executor, etc., the right to an accounting in equity is undoubted. The right in such cases is based upon the substantive equity of trusts which jurisdiction equity always had. 1 Ency. Pl. and Pr. 96." In point of fact, this is precisely the suit that the plaintiff has brought in this case. He stated a case against fiduciaries for an equitable accounting, alleging, presumably because the amount of damages could not be determined until further action by the Federal Power Commission, that there was no adequate remedy at law.

It seems clear upon the statement of the claim, and upon a recognition of the fact that the equitable cause of action is recognized in Florida to meet this precise type of situation, that the plaintiff was fully entitled in November 1958 to bring his bill in equity in the state court, or an action in the federal court to vindicate a State equitable right, seeking exactly the relief that he sought when his suit was filed in 1963. All the breaches of fiduciary duty alleged in the complaint occurred not later than November, 1958. These breaches of fiduciary duty gave rise to the right in the plaintiff to have an accounting made of the damages that would accrue therefrom. The fact that the amount of the damages could not be ascertained until a later date was the very circumstance that required the filing of proceedings of an equitable nature. When the contracts were executed, the claim had fully ripened so as to be the basis of an action. Such action not having been brought for more than three years after it accrued, it was barred by the three-year statute of limitations as determined by the trial court.

Nothing of substance is added by the appellant's contention that he has stated a claim sounding in unjust enrichment, which, he argues, could not accrue until the defendants first received returnable profits. No claim for restitution by fiduciaries in the classical sense, founded upon conflicts of interest, is alleged in this complaint. The complaint views the defendants' profits as "unjust," and therefore returnable to the corporation, only if they are "profits to affiliates" under the FPC rule. The true essence of the appellant's grievance if these profits are, as alleged, subject to the FPC rule, is their exclusion from Transmission's rate base with the consequent damage to the corporation. The profit-making of the defendants can not be separated from the damages to the corporation; they are absolutely equivalent.[4] There is no difference, quantitative or qualitative, between the delay in the advent of damages following the execution of the contracts and the delay in the advent of defendants' profits. If what appellant calls his "damage claim" accrued in November 1958, his "restitution claim" accrued at the same time. That was when the appellant "could first have maintained his action," as spelled out in his present complaint, "to a successful result." *Brownell* v. *City of St. Petersburg, supra.* Looking to "the aggregate of operative facts which give rise to a right enforceable in the courts," *Original Ballet Russe, Ltd.* v. *Ballet Theatre, Inc.*, 2 Cir. 1943, 133 F. 2d 187, 189, we find that the operative facts alleged in this complaint, giving rise to an

[4] If A converts B's property to his own use, there is both damage to B and unjust enrichment to A, but so far as the statute of limitations is concerned, nothing can be made of this separation.

action for an accounting based upon breach of fiduciary duty or unjust enrichment or both, were in existence and would have supported an action for an accounting in November, 1958. The fact that profits, and therefore damages, occurred at various times after that date is as insignificant in fixing the time when the appellant's essential complaint first could have been filed as is the fact that FPC action was not initiated until 1962.

The judgment of the trial court to the extent that it dismissed the claim as being barred by the statute of limitations is AFFIRMED. The judgment of the trial court is REMANDED to permit the remainder of the judgment to be amended in a manner not inconsistent with this opinion.

SIMPSON, District Judge—concurring:

My agreement with the opinion prepared by Chief Judge for the Court is complete and without reservation. Ordinarily, Judge Rives' dissenting opinion—with which, despite its characteristic force and persuasiveness, I disagree on nearly all questions raised—would call for no amplification by me of the views I share with Judge Tuttle. Perhaps here the majority view is so clear as to be better left without attempting embellishment. But, since Judge Rives wrote his dissent after and with a weather eye upon that of Judge Tuttle, and not, as sometimes occurs, after a conference in which all views are exchanged and argued to decision, I feel justified in preempting for the majority the trial lawyer's cherished right to "open and close".

First, I would emphasize that the Complaint here sets forth only one claimed breach of legal duty; only one "claim" or "cause of action", not two; only one basis for recovery. The only duality I can discover is in theories of recovery and computation of damages.

It is sophistry to assert the existence of two claims, one for "breach of trust" and a separate claim for "unjust enrichment", giving rise to an equitable right to an accounting.[1]

As developed on pages 10-12 of Judge Tuttle's opinion and Footnote 4 thereof, the breach of trust, if it occurred,

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[1] Old Florida and Alabama common law pleaders would question the complaint's averment of "no adequate remedy at law" having in mind the catch-all common count in an action of *assumpsit* for "money had and received", which, as the old cases demonstrate, could be based upon concepts of an equitable nature, or arising from equitable considerations. "Money had and received" was held to be broad enough to cover practically any situation developed at trial of the defendant being in possession of money or property rightfully belonging to the plaintiff, and for which money damages was an adequate remedy. This would include such concepts, *inter alia,* as "breach of trust" and typically, "unjust enrichment". *Moss* v. *Condict,* 16 So. 2d 921, 154 Fla. 153; *Sears* v. *Gulf Refining Co.,* 152 So. 1, 113 Fla. 714; *Gordon* v. *Camp,* 2 Fla. 422. Only if he needed discovery and examination of the defendants' records to establish damages, or if money damages would not be adequate relief, (and hence in either event "no adequate remedy at law") would the competent Florida pleader of my salad days have foregone a law action of assumpsit, with attendant jury trial of factual issues, for resort to bill in equity for accounting, usually tried twice, once before a Special Master in Chancery, and again before the Chancellor upon exceptions to the Master's Report.

It is equally clear from old Florida cases that prosecution of either remedy to judgment gave rise to a plea in bar (Law) or complete equitable defense (Chancery) of former judgment or *res judicata* in the event that the parallel remedy was later asserted on the other side of the Court. *Cragin, et al* v. *Ocean & Lake Realty Co.,* 135 So. 795, 101 Fla. 1324 (dictum); See: *Town of Boca Raton* v. *Moore,* 165 So. 279, 122 Fla. 350; *Kent, et al* v. *Sutker,* 40 So. 2 145.

was simply the cause of the claimed unjust enrichment, not a separate and divisible "claim upon which relief may be granted". The attempted division into two claims, or two "causes of action" will not withstand critical analysis.

The district judge had before him Rule 12(b)(6)[2] motions from all defendants addressed to the sufficiency of the Complaint. He concluded, rightly, I think, (and not, as I read Judge Rives' opinion, questioned by him) that the Florida three year Statute of Limitations[3] was applicable, and was proper for the Court to consider in disposing of Rule 12(b)(6) motions, provided the facts pleaded by the Complaint were sufficiently complete to demonstrate the limitation statute's application. He applied the limitation statute to what he, and now Judge Rives, mistakenly, we think, (*supra* and pages 10-12 of the majority opinion) construed as the first (breach of trust) of two separate and distinct claims or causes of action.

Our holding, in summary, is: that only one claim, not two, existed; that all, not part of it, was time-barred under the Florida Statute when suit was brought; and that the district court's attempted dichotomy was impermissible, as without legal or factual basis.

The *judgment* below was brought here on appeal, *not just part of it,* as Judge Rives argues, and the majority opinion simply directs that that judgment, now under our jurisdiction on appeal, be modified below to meet

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[2] Federal Rules of Civil Procedure.

[3] Fla. Stat. Sec. 95.11(5).

these views. Upon remand the suit will stand dismissed with prejudice, not with one portion of an indivisible whole dismissed with prejudice, and the remainder thereof dismissed without prejudice, as the district judge incorrectly attempted.[4]

In the next place, I have no quarrel with the legal and equitable principles discussed by Judge Rives at pages 19 and 20 of the dissent, with respect to the duties and liabilities of fiduciaries and those in privity with them toward a legally wronged or defrauded beneficiary. I accept also, without giving it the significance assigned to it by Judge Rives, the statement that there remains a *locus penitentiae,* that the fiduciary and his privies owe a duty of restitution to the beneficiary.

Of course this is so, otherwise there would never accrue a right of action, the breach of the legal duty to restore gains acquired through breach of trust.

But does this mean that no right of action accrues (and hence no running of time under the limitation statute) until some indefinite time in the future when both an opportunity to restore, and a failure to restore have taken place, as Judge Rives appears to argue? I do not believe so, but rather than once the beneficiary has knowledge,

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[4] As a Florida country boy, I often heard rumors of, but never saw, the mysterious "joint snake", commonly reputed to remain viable as two or more separate and complete snakes if chopped into two or more parts. I am even yet unable to assert with confidence (or competence) that such snakes do not exist. I can truthfully say that one has never come under my direct notice. Careful examination of the Complaint here raises no need for updating or revision of this statement. I still haven't seen a "joint snake".

actual or constructive, of the wrong to him and his purse, actual or potential, great or slight, the inexorable and inescapable time-running process of the limitation statute takes hold. This occurred, according to the Complaint in early November, 1958, more than three years before suit was filed.

Finally, *if* we of the majority have misunderstood and misconceived the nature and legal consequences of the matters set forth in the Complaint, and the appellant Ross does have two separate and severable claims, and *if* the dismissal of one claim without prejudice by the district judge ought of right to stand undisturbed, (as unappealed by the defendants and now final) it should be kept in mind that the *dismissal* of this claim *is* permitted to stand. All that is removed is the "without prejudice" label appended to that dismissal by the district court.

If this provision of the order appealed from were permitted to stand undisturbed, and if our views as to the accrual date (November, 1958) of all claims, or partial claims, or parts of claim, are correct,[5] and we believe they are, and suit was later brought by Ross, the defendants could raise the Florida 3-year limitation statute (Fla. Stat. Sec. 95.11(5), *supra*) as a bar to recovery. The *bar would be complete.* What and all that is accomplished by

[5] Judge Rives' opinion does not follow the district court's conclusion that the two asserted claims accrued and will accrue at different times, i.e., one (breach of trust) now time-barred, one (unjust enrichment) now prematurely asserted. He (Judge Rives) argues only that both will accrue in the future, but presumably at the same time, "the conclusion of the Federal Power Commission's decision and its review by the courts". (Conclusion, page 21, dissent.)

the present majority direction to the lower court is to afford the defendants (in a later suit) an additional plea in bar, *former judgment.*

Two bars accomplish no more than one, so that the jurisdictional argument is practically no more than an interesting intellectual exercise.[6]

With deference to and high respect for the views of Judge Rives, I am constrained, after reconsideration of the majority opinion in the light of Judge Rives' opinion, to concur in Judge Tuttle's opinion for the reasons lucidly set out by him and further upon the basis of the additional or amplified reasons here attempted to be developed.

RIVES, Circuit Judge, dissenting:

With deference, I dissent.

The district court held that the claim for damages resulting from a breach of fiduciary duty is barred by the statute of limitations and that the claim for unjust enrichment is premature. Accordingly it dismissed the action but expressly made the dismissal "without prejudice to the right of the plaintiff to bring a further action for relief for restitution and unjust enrichment at such time as an order of the Federal Power Commission in the pending rate base proceeding becomes final."

The plaintiff alone filed a notice of appeal. None of the defendants appealed. Now this Court holds that both claims

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[6] If we accept Gertrude Stein's assertion that "a rose is a rose is a rose" it seems to me equally correct in this context to proclaim that "a bar is a bar is a bar".

were barred by the statute of limitations and that the entire action should have been dismissed with prejudice.

On their claimed defense of the statute of limitations addressed to the claim of unjust enrichment, the district court ruled against the defendants. The defendants having failed to appeal, I submit that they can no more rely on the statute of limitations as to the claim of unjust enrichment than if they had failed to plead that defense in the first instance. To the extent that the judgment was adverse to the defendants it became final without appeal, and this Court is without jurisdiction to enlarge the rights of the defendants.[1]

Laying aside the jurisdictional question, I submit that neither claim is barred by the statute of limitations. Florida Gas Company (F.G.C.) and Florida Gas Transmission Company (Transmission) held no claim upon which relief could be granted as early as November 1958 when the contracts were executed. Those contracts did no more than expose F.G.C. and Transmission to the risk of injury conditioned on the occurrence of two subsequent events: (1) The receipt of profits by the contracting firms; and (2) the elimination by the Federal Power Commission of those profits from Transmission's rate base. Unless and

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[1] The William Bagaley, 1866, 72 U.S. 377, 412; United States v. American Ry. Express Co., 1924, 265 U.S. 425, 435; Morley Co. v. Maryland Casualty Co., 1937, 300 U.S. 185, 191; Helvering v. Pfeiffer, 1937, 302 U.S. 247, 251; Le Tulle v. Scofield, 1940, 308 U.S. 415, 422; Southern Bell Telephone Co. v. Southern Precision Pattern Works, 5 Cir. 1958, 251 F. 2d 537, 540; Abel v. Brayton Flying Service, 5 Cir. 1957, 248 F. 2d 713, 717; Schildhaus v. Moe, 2 Cir. 1963, 319 F. 2d 587, 588; Zellinger v. Uvalde Rock Asphalt Co., 10 Cir. 1963, 316 F. 2d 47, 54; 7 Moore, Federal Practice ¶72.05 (2d ed. 1953).

until profits accrued to the contracting firms, the defendants' breach of duty to the plaintiff was not complete for only profits could be eliminated from the rate base. The contracts contemplated reasonable profits to the contracting firms, but, as of the dates of the contracts, the actual receipt of the hoped for profits was speculative and uncertain. Assuming, however, that to be untrue and that the contemplated profits were so large as to make their receipt virtually a certainty, there remained a locus poenitentiae.

A fiduciary and third persons colluding with a fiduciary who obtain a benefit from a breach of the fiduciary's duty are under a duty of restitution to the beneficiary.[2] It could not be presumed in advance that the defendants would breach that duty so as to make the claims complete as of the dates of the contracts.

Further, profits, even when received and retained by the contracting firms, did not give rise to a claim on which relief could be granted until the Federal Power Commission actually began to eliminate those profits from Transmission's rate base. Until that event it could not be known with any degree of certainty that the receipt of reasonable profits by the contracting firms was unjust or wrongful, or that the defendants had committed any legal injury to F.G.C. and Transmission.

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[2] Jackson v. Smith, 1921, 254 U.S. 586, 588, 589; Flight Equipment & Engineering Corp. v. Shelton, Fla. 1958, 103 So. 2d 615, 625; A.L.I. Restatement, Restitution §§ 138, 190. Indeed, a broader principle not restricted to fiduciaries and those colluding with them might be applicable, to the effect that "A person is not permitted to profit by his own wrong at the expense of another." A.L.I. Restatement, Restitution § 3, §§ 128-137; see also Prosser on Torts, §82, p. 486 (2d ed. 1955).

The situation is analogous to *Town of Miami Springs* v. *Lawrence,* Fla. 1958, 102 S.2d 143, where the action was based on the fact that the town raised the level of a street and failed to provide drainage for the plaintiff's land. In denying the defense of limitations, the Florida Supreme Court held:

> "... the statute does not begin to run until actual harm is inflicted to the plaintiff's land, regardless of the installation date of the construction or obstruction causing the overflow. See 56 Am.Jur., Waters, §444; Baker v. Fort Worth, 1948, 146 Tex. 600, 210 S.W.2d 564, 5 A.L.R.2d 297; Henderson v. Talbott, 1954, 175 Kan. 615, 266 P.2d 273; annotation in 5 A.L.R.2d pp. 302 et seq."

See also *Duchaine* v. *Grosco Realty Co.,* Fla.App. 1960, 121 So.2d 679.

With deference, I submit that neither claim is barred by the statute of limitations. I submit, further, that neither claim should be dismissed as premature, but rather that a stay should be directed pending the conclusion of the Federal Power Commission's decision and its review by the courts.[3]

For the reasons stated, I respectfully dissent.

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[3] See Best v. Humboldt Placer Mining Co., 1963, 371 U.S. 334, 338-9; Hewitt-Robins v. Eastern Freight-Ways, 1962, 371 U.S. 84; Thompson v. Texas Mexican R. Co., 1946, 328 U.S. 134, 151; General Amer. T. Car Corp. v. El Dorado Term. Co., 1940, 308 U.S. 422, 433; United States v. Morgan, 1939, 307 U.S. 183, 198; Mitchell Coal & C. Co. v. Pennsylvania R. Co., 1913, 230 U.S. 247, 266-7; McCleneghan v. Union Stock Yards Co., 8 Cir. 1962, 298 F. 2d 659, 670.

APPENDIX B

Petition for Rehearing

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 21,089

FRANK ROSS,

Appellant.

—versus—

F. E. STANLEY, et al.,

Appellees.

PLAINTIFF-APPELLANT'S PETITION FOR REHEARING AND REHEARING EN BANC

To the Honorable the Chief Judge and the Judges of the United States Court of Appeals for the Fifth Circuit:

Plaintiff-appellant Ross applies (1) for a rehearing of his appeal and of the Court's decision of June 1, 1965; and he moves (2) that such rehearing be held en banc (Rules 25a and 29 of this Court).

The following is a brief statement, without argument, of the grounds for rehearing and of the reasons for directing it to be held en banc. The arguments in support of the application are set forth in the annexed brief.

Appendix B—Petition for Rehearing

I. Grounds for rehearing.

Plaintiff-appellant respectfully submits:

1. The Court erred in holding (Op. 2, 12, 17) that this action and the claims alleged therein are barred by the statute of limitations.

2. The Court erred in holding (Op. 7, 12) that this action could have been maintained "to a successful result" as early as November 1958.

3. The Court overlooked the express admission of defendants-appellees* that, in November 1958, it was wholly uncertain whether there would ever be any profits for defendants (and, hence, any damages to the gas companies).

4. The Court held correctly that "The true essence of appellant's grievance * * * is [the] exclusion [of defendants' profits] from Transmission's rate base with the consequent damage to the corporation" (Op. 11). This holding is inconsistent with the Court's conclusion that plaintiff's claim accrued at a time (November 1958) when the facts constituting its "true essence" had not yet materialized because defendants' profits had not come into existence, let alone had been excluded from the rate base.

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* "Whether the contracting firms 'would profit' * * * was 'speculative and uncertain,' not a fact on which a cause of action can be based. Indeed, the contracting firms when agreeing for a firm price to render the services stood not only possibly to make a profit, but to the contrary stood to sustain a loss."

(P. 66 of the main brief for defendants-appellees F. E. Stanley et al.)

5. The Court overlooked that, for purposes of the administrative no-profit-to-affiliates rule, only the FPC can make a finding of "affiliation". Such a finding, essential to this action, did not exist and could not have been procured in November 1958.

6. The Court (Simpson, J.) erred in holding (Op. 16) that not only an actual but also a "potential" wrong can start the running of limitations.

7. The Court held (Op. 8-9) that, if plaintiff had a claim in 1962, when the action was brought, he must have had a claim in 1958, because no material facts intervened. The Court overlooked a material intervening change: Profits actually accrued to defendants. Because of these profits, Transmission was forced actually to reduce its rates, thus suffering actual damage.

8. On Chief Judge Tuttle's premise that this is a purely equitable action for an accounting (Op. 10), the Court erred in applying the Florida statute of limitations instead of the doctrine of laches.

9. On Judge Simpson's premise that the remedy at law for money had and received was adequate (Op. 13, fn. 1), the Court erred in holding that the claim for defendants' profits accrued in November 1958, long before any profits were actually "had and received" by defendants.

10. On Judge Simpson's premise that the running of limitations begins "once the beneficiary has knowledge, actual or constructive, of the wrong to him and his purse" (Op.

16), the Court erred in holding, by necessary implication, that such knowledge existed in November 1958.

11. The Court's holding that limitations began to run at a time (November 1958) when actually this action could not have been brought and maintained to a successful result, deprives plaintiff and the gas companies, on whose behalf this action is brought, of their property without due process of law, contrary to the Fourteenth Amendment of the Constitution of the United States.

12. The Court erred, and acted without jurisdiction, in dismissing plaintiff's profit claim with prejudice, when the District Court had dismissed it without prejudice and defendants did not appeal from the District Court's decision or any part of it.

II. Reasons for rehearing en banc.

Rehearing en banc should be directed becaused unusually important and novel questions are to be decided and because it is necessary in order to maintain uniformity in the decisions of the Court.

1. The Court's decision affects not only this plaintiff, his 25,000 co-stockholders and their $8,000,000 claim, but a multitude of other utility corporations throughout the land, which are subject to FPC regulation and are exposed to fiduciary abuses similar to those charged in this action.

2. The novel and unprecedented effect of the Court's decision will be to compel public utilities stockholders to

swamp the courts of the land with actions based on nothing better than a speculative guess that their corporations *may* suffer injury and damages in the indefinite future.

3. Alternatively, the novel and unprecedented effect of the Court's decision will be the destruction of the claims of those public utilities stockholders who refrain from going to court until their corporations actually sustain injury and damages.

4. The Court's decision departs from this Court's holding in *United States* v. *Reid,* 251 F. 2d 691, 694 (Cir. 5, 1958), that a wrongful act does not give rise to a cause of action, and does not start the running of limitations, until *some* damage actually results.

5. The four Judges here and below have written four sharply divergent opinions. In this Court, the case did not have the benefit of a judicial "conference in which all views are exchanged and argued to decision" (Op. 13). The two active Judges of this Court, who participated in the decision, were evenly divided.

A more detailed argument in support of a rehearing en banc is presented in the annexed brief.

The undersigned counsel hereby certifies that the foregoing petition is presented in good faith and not for delay.

WHEREFORE, petitioner respectfully prays for a rehearing, moves that such rehearing be held en banc, and asks for such other relief as may be just.

Appendix B—Petition for Rehearing

Dated: June 18, 1965.

Respectfully submitted,

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APPENDIX C

Order of the Court of Appeals Denying Petition for Rehearing

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 21089

FRANK ROSS,

Appellant,

—versus—

F. E. STANLEY, et al.,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF FLORIDA

(July 13, 1965)

ON PETITION FOR REHEARING

Before TUTTLE, Chief Judge, RIVES, Circuit Judge, and SIMPSON, Distirct Judge:

Per Curiam:

It is ORDERED that the petition for rehearing filed in the above styled and numbered cause be, and the same is, hereby denied.

RIVES, Circuit Judge, I dissent.

APPENDIX D

Statutes Involved

§ 2 of the Natural Gas Act, 15 USC § 717a

§ 717a. *Definitions*

When used in this chapter, unless the context otherwise requires—

* * * * *

(6) "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.

* * * * *

§ 6 of the Natural Gas Act, 15 USC § 717e

§ 717e. *Ascertainment of cost of property*

(a) The Commisison may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

* * * * *

§ 208 of the Federal Power Act, 16 USC § 824g

§ 824g. *Ascertainment of cost of property and depreciation*

(a) The Commission may investigate and ascertain the actual legitimate cost of the property of every public

utility, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation, and the fair value of such property.

* * * * *

§ 95.11(5) OF THE FLORIDA STATUTES

Actions other than those for the recovery of real property can only be commenced as follows:

* * * * *

(5) Within three years—

* * * * *

(c) An action for taking, detaining or injuring any goods or chattels, including actions for the specific recovery of personal property;

* * * * *

(e) And an action upon a contract, obligation or liability not founded upon an instrument of writing, including an action for goods, wares and merchandise sold and delivered and on store accounts.

APPENDIX E

Opinion No. 431 of Federal Power Commission

UNITED STATES OF AMERICA

FEDERAL POWER COMMISSION

Before Commissioners: JOSEPH C. SWIDLER, Chairman, L. J. O'CONNOR, JR., CHARLES R. ROSS, HAROLD C. WOODWARD, and DAVID S. BLACK.

Docket No. RP61-3

Docket No. RP61-4

FLORIDA GAS TRANSMISSION COMPANY

COASTAL TRANSMISSION CORPORATION

Opinion No. 431

OPINION AND ORDER ON ACCOUNTING FOR CONSTRUCTION PROFITS AND CONSOLIDATED TAX, ADOPTING EXAMINER'S DECISION WITH MODIFICATION

(Issued June 8, 1964)

SWIDLER, Chairman:

This proceeding concerns (1) the proper accounting for Florida Gas Transmission Company's pipeline construction costs representing profits of allegedly affiliated en-

gineering and construction companies and (2) the accrual of Federal incomes taxes on the books of Coastal Transmission Corporation. These issues were reserved in the Commission's order of June 8, 1962 (27 FPC 1123), accepting a proposed settlement of rate proceedings.

The corporations here involved were organized to transport natural gas from Texas to Florida. Houston Texas Gas and Oil Corporation (Houston Texas) and Coastal were granted a certificate for the pipeline by Opinion No. 301 (16 FPC 118) issued December 28, 1956,[1] and have completed the construction. Since that time the companies have merged and are now known as Florida Gas Transmission Company; and the name of their parent, The Houston Corporation, has been changed to Florida Gas Company.

On the first question there is an issue as to whether there was an affiliation between Houston Texas and the engineering and construction firms, and, if so, whether that part of the pipeline costs representing profits to these firms should be eliminated from the company's plant accounts. There is also a subsidiary question as to whether the profits should not be reduced by certain overhead costs of the construction firms. On the second question the issue is whether Coastal should be able to accrue a tax although it was included in a consolidated income tax return on which no taxes were payable.

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[1] Affirmed as *Florida Economic Advisory Council* v. *F.P.C.*, 251 F. 2d 643 (CADC), certiorari denied 356 U.S. 959.

Appendix E—Opinion No. 431 of Federal Power Commission

I. The Costs Resulting from Profits of the Construction and Engineering Group

As a result of the Commission's order of June 8, 1962, a hearing was held in which it was developed that total cash outlays for the pipeline amounted to $112,439,325 for Houston Texas and $60,091,410 for Coastal, and these were recorded in the plant accounts of the companies. A part of the amount spent by Houston Texas was paid to four engineering and construction firms, Barnard & Burk, Midwestern Constructors, Inc., Walco Engineering and Construction Co., and Harbert Construction Corporation. The staff found that the total payments to these firms included $9,659,183 in excess of their actual costs.[2] The staff recommended that this amount with corresponding interest during construction of $304,950, amounting in all to $9,964,133, should be eliminated from the plant accounts. On the basis of the record the examiner found in his decision dated September 23, 1963, that the firms became part of an affiliated group in the promotion of Houston Texas and that the construction profit should be eliminated from its plant accounts. We agree with the examiner's conclusion but modify it below with respect to overhead costs of the construction firms.

The question of affiliation must be determined on the basis of the entire history of the pipeline and of the corporations involved. Originally, for the purpose of building

[2] $5,919,065 applicable to the joint venture composed of Midwestern and Walco; $3,082,810 applicable to Harbert and $657,306 applicable to Barnard & Burk.

a pipeline to New York or Chicago a Texas corporation known as Houston Texas Gas and Oil Company (Houston Texas Company) was organized May 12, 1952, by one J. O. Mack, a successful oil producer, and he was joined by his wife, H. S. Mack, and his son-in-law, A. R. Kleinkauf. Later O. Paul Herzig became chief engineer and a director, and F. R. Smith became associated with the enterprise. The capital structure of this company consisted of 1,000 shares at a par value of $1.00 per share, and this was never increased. Because Mr. Mack did not have available the necessary financial resources or experienced personnel he made efforts to interest other firms in the project.

Mr. Charles C. Barnard was the first such investor to join the group. Mr. Barnard, who met Mr. Mack on his own initiative early in 1954, was a partner in the consulting engineering firm of Barnard & Burk. After a series of conversations it was orally agreed that Barnard & Burk would prepare a survey of the Florida market at their expense, that they would be reimbursed for costs when funds were available, that they would do the engineering for the project at the going fee for the type of work involved, and that out of cash or services they would be permitted to purchase a certain amount of founders' stock.

Later Mr. John M. Harbert, president of Harbert Construction Corporation, Mr. Paul C. Wallack, president of Walco, and Mr. F. E. Stanley, president of Midwestern Constructors, Inc., also heard about Mr. Mack's plans, met Mr. Mack and eventually joined the enterprise. Through oral agreements with Mr. Mack each of these individuals

agreed to advance risk capital and to contribute their knowledge and experience; in turn they were to be given the right to construct a portion of the pipeline and to acquire stock participation in the project.

On July 22, 1954, Houston Texas was incorporated in Delaware for the purpose of acquiring the assets of Houston Texas Company and constructing a natural gas pipeline, and Mr. and Mrs. Mack and Mr. Kleinkauf became the first directors. Later Mr. Mack's associates Herzig and Smith became directors and numerous meetings were held at which plans for constructing the project were developed. By September 16, 1954, Messrs. Harbert, Wallack and Stanley were advancing small amounts of risk capital, and on October 27, 1954, along with Mr. James Roddy of the financial firm of Scharff and Jones in New Orleans and Mr. Barnard, met with officials by Blyth & Company in New York to work out arrangements for that firm to act as underwriters and investment advisers for the project.

On December 8, 1954, the board of directors of the new company approved the oral agreements that Mr. Mack had made, now reduced to writing in the form of stock subscription agreements with respect to providing funds, and in the form of letter agreements with respect to the performance of the work. The board then consisted of Mr. Mack, Mrs. Mack, and Messrs. Kleinkauf, Herzig, and Smith. The board also approved the acquisition of the assets of The Houston Texas Company. After this and at the same meeting it voted to increase its membership to include Messrs. Barnard, Harbert, Wallack, and Stanley, and Mr. Stanley

was elected Chairman. Mr. T. Rinehart, Mr. Stanley's legal counsel, was appointed general counsel and was granted an option to purchase stock. On the same day Midwestern and Walco, Harbert, and Barnard & Burk subscribed in all to 37.5 percent of the stock in Houston Texas.

The letter agreement with Barnard & Burk provided that if Houston Texas acquired a certificate it agreed to employ Barnard & Burk as engineers under a contract "incorporating a cost or fees no higher than an arm's length contract for similar services under similar circumstances." The agreement specifically provided that "the amount of the fees and compensation set forth herein are not, and shall not be deemed to have been, agreed to at this time." Attached to the letter agreement, which was accepted by Barnard, was a form of contract to be executed later.

The letter agreements with Harbert Construction Corporation, and with Midwestern and Walco acting jointly, both provided for a "cost no higher than an arm's-length contract for similar work under similar circumstances." In the Harbert agreement Houston Texas agreed to employ the firm to construct the 18-inch main line from Haines City, Florida, to Miami, Florida, including all laterals. In the Midwestern-Walco agreement Houston Texas agreed to employ the firm to construct all main line facilities from a point near Bay St. Louis, Mississippi, to Haines City, Florida.

In February of 1955 Houston Texas made arrangements to obtain a gas supply from Coastal, then a wholly owned subsidiary of Delhi-Taylor Oil Corporation, and it became

necessary for the investors in Houston Texas to divest themselves of part of their interest to permit Delhi-Taylor to purchase an interest. On August 26, 1955, Houston Texas filed its application with the Commission for a certificate. At the time the application was heard the Houston Texas stock was owned as follows: Barnard & Burk, 10.2 percent; Harbert, 5.1 percent; Midwestern group, 9.6 percent; Walco group, 10.0 percent; Mack group, 35.7 percent; Delhi-Taylor, 14.3 percent; investment bankers, 11.4 percent, and others, 3.7 percent. The board of directors then was composed of Barnard, Bashore (vice president of Blyth and Co.), Harbert, Herzig, Kleinkauf, Rinehart, Roddy, Stanley, Wallack, and Mrs. Mack.

In March 1957 The Houston Corporation was formed, and all stockholders of Houston Texas exchanged their stock for shares in The Houston Corporation of which Houston Texas was now the 100 percent subsidiary. In June 1958 The Houston Corporation obtained by exchange of stock all of the stock of Coastal, and Delhi-Taylor became owner of 48.3 percent of the stock of The Houston Corporation.[3] Changes were also made in the board of The Houston Corporation which thereafter consisted of W. J. Bowen, president of Coastal; Harold A. Martin, vice president of a bank in Jacksonville, Florida; Carl M. Mueller, vice president, Bankers Trust Company, New York City; Leon M. Payne, a Houston lawyer; Rinehart; Barnard; and Stanley, who was Chairman of the Board

[3] Delhi Taylor's ownership consists only of Class A stock which had one-tenth of a vote per share until 30 days after the public financing in August of 1958 when it had one-fourth of a vote per share.

and president. At the same time the board of Houston Texas was revised to consist of Bowen, Herzig, Kleinkauf, Payne, Rinehart, Stanley, and Mrs. Mack.

In August of 1958 The Houston Corporation carried out the necessary public financing. Definitive contracts containing prices at which the work was to be performed were negotiated and were approved by the board of Houston Texas on October 23, 1958.[4] At that time the composition of the boards of directors of The Houston Corporation and Houston Texas were the same as those listed above for June of 1958. The testimony shows that regardless of their legal import, all of the new directors of The Houston Corporation and Houston Texas assumed that the letter agreements were to be honored as at least a "moral obligation," and no consideration was ever given to adopting a different mode for determining who would do the work involved.

At this time in addition to being a director of each company, Mr. Stanley was chairman of the board and president of The Houston Corporation and president of Houston Texas. The maximum percentages of stock owned by the engineering and construction representatives in The Houston Corporation at any time subsequent to the public financing up until December 1960 were as follows: Mr. Barnard, 0.9 percent; Mr. Harbert, 3.3 percent; Mr. and Mrs. Stanley, 2.4 percent, and Mr. and Mrs. Wallack, 3.0 percent, or 9.6 percent in all. Because of the large offering of common stock to the public (1,809,400 shares or 52%)

[4] The contracts had been previously submitted to the board of The Houston Corporation and in effect approved.

the shares held by the engineering and construction representatives are not insignificant.

While the relative stock interest of the engineering and construction group in the pipeline enterprise declined in the period between the approval of the letter agreements in December 1954 and the ratification of the definitive contracts in October 1958, the influence on company policy exerted by the original group of promoters persisted. After the execution of the letter agreements the record shows that Messrs. Stanley, Wallack, Harbert, and Barnard devoted a great deal of time and effort to the problems of getting the pipeline built and the enterprise established on a business basis. Their entrenched position is shown by the fact that several inquiries by other firms about constructing the pipeline or performing engineering services were answered by the statement that the work had already been awarded to the four firms involved here. Even the negotiation of definitive contracts could not be separated from the same group. At the meeting of the board of directors of Houston Texas on March 19, 1957, the president, Mr. Stanley, appointed separate committees to negotiate contracts with Barnard & Burk and the three construction companies. Mr. Stanley appointed Messrs. Herzig and Rinehart and himself to deal with Barnard & Burk,[5] and Messrs. Herzig, Barnard and Rinehart to deal with the construc-

[5] The agreement with Barnard & Burk was never brought to a definitive contract, but the record shows that the parties acted within the terms of the appendix to the letter agreement. Under these terms Barnard & Burk would receive a percentage of the pipeline costs, but this was limited later by oral agreement. Competitive bids were not sought from other firms.

tion companies. Thus members of both committees were on the same board of directors, had common interests [6] and were appointed by the president who was a representative of one of the construction contractors. Mr. Stanley testified, that "the persons negotiating the Midwestern-Walco contracts were under strict and absolute instructions to negotiate those contracts in accordance with the provisions of the letter agreements." All of the work was offered to the construction firms and awarded to them except for certain river crossings, laterals, and meter and regulator stations for which the committee thought the proposals of the construction firms were too high after checking with other contractors.

The evolution of this enterprise, which must be traced through the complicated details of stock ownership, agreements, financial needs and personal relationships, is plain enough in general pattern. A group of promoters combined their talents and resources, and representatives of the engineering and construction firms were members of this original group. As the enterprise expanded other persons and other resources were brought in, but representatives of the engineering and construction firms remained at the center of the operation where they were in a position to protect their rights to perform the services, the cost of which is involved here.

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[6] While Rinehart, who owned 9.8% of the common stock of The Houston Corporation before the public offering, was not personally interested in the construction contractors, he was or had been Mr. Stanley's lawyer and had been brought into the company through Stanley.

Appendix E—Opinion No. 431 of Federal Power Commission

There may never have been any formal agreement between the members of the engineering and construction group and the Mack interests to control jointly the several companies through which they operated. However, it is clear that the Mack group was dependent upon the construction and engineering group and could not have repudiated the oral agreements with the construction and engineering group (or its individual members) when on December 8, 1954, the Mack interests had Houston Texas (in which they momentarily owned all the stock and made up the entire board of directors) approve the agreements in written form. Absent the participation by the construction and engineering group which was consummated immediately thereafter Houston Texas was a mere shell.

By no sensible interpretation can the transactions of December 8, 1954, properly be characterized as an arm's-length bargain between a controlling Mack group and a minority construction and engineering group. They were, instead, a series of agreements between a corporation and contractors who were an integral and essential element of the corporate management, and who could destroy the corporation unless it agreed to their prearranged transactions. We hold that as of the time the construction and engineering group occupied a position where they were able to control the actions of the company in the awarding of construction and engineering contracts, that they exercised this control in favor of their own firms, and that the contracts in issue reflect this relationship.

It is arguable that during the subsequent four years the construction and engineering group lost the absolute power

to impress their will upon the pipeline company, parent or subsidiary. It is unquestionable, however, that throughout this period the group or its representatives remained as active participants in the company management, and that the new members of the board of directors of the parent company made no effort to reconsider the 1954 determinations but treated them as binding. Under these circumstances we do not believe that it can properly be concluded that the original affiliation taint has been purged, or that the October 1958 ratification of the earlier agreement represented an independent judgment by the parent company to employ the construction and engineering group because they could perform the work as well and as cheaply as any other group.[7]

We think that our rule against profits to affiliates precludes allowing their profits in the plant accounts of Houston Texas. The no-profits-to-affiliates rule goes far back in Commission history. See for example *Alabama Power Co.*, 1 FPC 25, 39, aff'd *Alabama Power Co.* v. *McNinch*, 94 F. 2d 601 (CADC 1937); *Louisville Hydro-Electric Company*, 1 FPC 130, 133, aff'd *Louisville Gas & Electric Co.* v. *F.P.C.*, 129 F. 2d 126 (CA6 1942), cert. den. 318 U.S. 761. The basis of this rule is that a profit made by an enterprise dealing with itself does not represent cost. As we indicated in *St. Croix Falls Minnesota Improvement Company, et al.*, 3 FPC 13, 21, it is "impossible and unrealistic to determine whether profits paid to an

[7] We do not hold that an affiliation condition which would call for application of the rule can never be eliminated once created, but only that it was not here.

affiliated construction company are 'reasonable profits' " and "comparison [with] over-all cost, including the affiliated company's profit, with what might have been cost if actual competition for the work had existed and if the work had been done by a non-affiliated construction company is sheer speculation."[8]

To prevent the evils which have been the subject of past proceedings the rule against profits to affiliates must be sufficiently broad to cover fact as well as form. The dissent suggests the rule should apply only where there is a situation of complete control and, further, complete control at the point in time when the formal contracts were executed on October 23, 1958. We do not agree. The purpose of the rule is to prevent insiders taking advantage of their position and creating costs which are not subject to the check of ordinary business relationships. *CF.*, Section 10 of the Clayton Act, 15 U.S.C. § 20.[9] We do not think that some particular percentage of stock or of common officers or directors can be allowed to be determinative of whether the rule should apply, although these factors are relevant

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[8] In the *St. Croix* case the Commission by way of footnote indicated that it was using the term "affiliated company" there in the sense of the definition of this term in our Uniform System of Accounts. For the reasons set forth in this opinion we do not believe there is any basis for limiting the so-called "no-profits-to-affiliates" rule to such situations.

[9] This section makes it a crime for any common carrier to make any contracts for construction in an amount more than $50,000 with another firm when the carrier shall have upon its board of directors or as its president, manager, or purchasing officer any person who is at the same time a director or manager or who has a substantial interest in the firm, except under competitive bidding.

to determine when a relationship exists that calls for application of the exclusionary rule. That the contractors or promoters could not have dictated policies or ordered the execution of contracts if all other interests had chosen to oppose them cannot validate a relationship which by its very nature and history precludes unhampered bargaining, especially if the contractors or promoters were, as here, clearly dominant when the original contracts were agreed upon. If control exists, sufficient to dominate the execution of the contracts in the face of united opposition, that makes the rule automatically applicable; but our inquiry is not at an end if we conclude that the insider's influence resulting in the contract is or became somewhat less than this degree of control.

The dissenting opinion, citing *Florida Power Corp.*, 1 FPC 390 (1937), argues that affiliation must be determined solely with reference to the situation prevailing as of the date the formal employment contracts were executed, and that indicia of control or influence at earlier periods are irrelevant. The *Florida Power* case, however, presented a situation where there never were any dealings between company insiders and construction or engineering firms under their control: the employment contracts in issue resulted from the arm's-length bargaining between the original promoters of a company and a completely unrelated concern, which as part of the consideration for purchasing the promoters' stock agreed to employ them subsequently to build the project involved. It was this fact, rather than the corporate situation when the employment agreements

were subsequently ratified (by which time the original promoters had long since ceased to have any relationship to the company), which led the Commission to allow reasonable profits on the work done. If the rule requiring disallowance of profits to affiliates could be circumvented by the resignation of the insider (or his sale of stock) after he enters into an employment agreement, but prior to its being converted into a formal contract, it would be seriously weakened as an effective sanction against such activities.

We also need not consider whether, as the dissent suggests, there may be other situations involving less than arm's-length bargaining in which the public interest can be adequately protected by approaches not calling for exclusion of a supplier's or contractor's profits from company costs. The rule that profits from contracts of a supplier or contractor affiliated with the regulated company should be excluded from its cost of service has proved its worth and is fully applicable here upon any realistic test of what occurred.

It has been suggested by the dissent that the effect of our decision here will discourage the promotion of pipeline projects by promoters pooling their interests. Of course, we have no such intention. We do not object to promoters making a profit on their investment of time, effort and financial resources in a developing pipeline enterprise. They will presumably realize this profit on the enhanced value of the shares of stock distributed to them. What we do object to is the engineering and contracting promoters profiting a second time on contracts between themselves

and the organization they are promoting at the expense of the gas consumers.

Houston Texas points out that full disclosure of the relation of the pipeline enterprise with the engineering and construction companies was made in the certificate proceeding and that the Commission's opinion shows that the engineering and construction costs would be allowed if reasonable. Houston Texas also contends that the examiner erred in refusing to admit and consider evidence of their reasonableness. The arguments rest on the following language of the Commission in its certificate opinion (16 FPC at p. 142):

> "Finally, it appears that the labor necessary for construction of the facilities of Houston Gas will be furnished by three construction companies, the president of each of which is an official and director of Houston Gas and that two of these construction companies own blocks of Houston Gas stock. Furthermore, a member of the firm of engineers which will supervise the construction and operation of the pipeline is also a vice president and director of Houston Gas. While as we have already stated, the cost of the proposed facilities appears to be reasonable, in view of this fact, this cost will be carefully scrutinized in any future proceeding dealing with accounting or rates of Houston Gas."

We agree with the examiner that Houston Texas misconstrues the purpose of the language in the certificate opinion. There the Commission was making a determination on the feasibility of the project. In its opinion the cost

appeared to be reasonable from this standpoint, but it specifically deferred consideration of the costs in relation to the affiliation question. On its face the language is a warning that because of the affiliation problem contract costs would not be accepted at face value but would be subject to scrutiny. We do not see how it can be converted into assurance that the contract prices would be accepted. If they are not accepted because of affiliation, there can be only one course, disallowance of insider profits.

Houston Texas' interpretation assumes that the Commission would abandon its long-standing rule against profits between affiliates with no discussion or consideration. Such an interpretation does not seem warranted, and it is therefore not relevant to inquire into the reasonableness of the profits. There is no reason in the record to doubt that the engineering and construction costs, apart from the profits, were reasonable.

In computing the profit arising from the engineering and construction contracts the staff did not include certain costs representing company overhead and arising largely before commencement of construction of the pipeline project. Houston Texas contends that these overhead charges, amounting to $312,809 for Harbert Construction Corp., $953,243 for Midwestern and $456,586 for Walco, should reduce the profits earned by the construction companies. The staff contends with respect to Midwestern and Walco that it properly allowed only the costs of their joint venture and disallowed any costs attributable to the separate corporate entities inasmuch as the costs incurred by the

separate entities were not associated directly with the construction of the pipeline. The staff also objects to allocating a portion of the general and administrative expenses of Harbert for the period 1955 through 1958 to reduce the profits of Harbert on the grounds that these costs arose prior to the actual construction, were incurred through efforts to obtain gas sales contracts for the pipeline and represent pre-operational expenses. In our opinion the overhead costs of all three construction companies claimed by them were shown by the record to be associated with the pipeline construction and went to reduce the actual profit they obtained from their contracts with Houston Texas. Therefore the profits disallowed by the staff in the amount of $9,659,183 should be reduced by $1,722,638 to $7,936,545. Interest on the reduced amount would be $250,565, making $8,187,110 in all.

II. Accrual of Taxes on Books of Coastal

The second issue reserved for consideration in these proceedings arises because Coastal accrued on its books $1,737,000 in Federal income taxes for May 1961 through August 1962 when it was merged with Florida Gas Transmission Company, but did not owe or pay such taxes because the consolidated returns filed by the parent company, The Houston Corporation, for the years 1958 through 1961 showed net losses, and it was expected that such losses would occur until 1965. We agree with the examiner that since Coastal did not pay such taxes or become liable to pay them, these amounts should not be accrued on its books, and we adopt the examiner's discussion on this point. We

may point out further that in our opinion Coastal's argument in its exceptions that the *Northern* case,[10] cited by the examiner, is distinguishable and has no merit. Coastal points out that the *Northern* case involves the special treatment given intangible well drilling costs and percentage depletion. It makes no difference whether no tax is paid because there are tax losses resulting from the use of these statutory deductions or whether the losses are operating losses. The point is that where there is no tax liability on a consolidated basis, none should be accrued on Coastal's books and, of course, no taxes would be allowed in a rate case in accordance with our *Cities Service* opinion.[11]

Coastal seeks to interpret the Commission's Uniform System of Accounts as permitting accrual of taxes in that Section 7, Current and Accrued Liability, under "Balance Sheet Accounts" provides that accrued taxes shall be classified "as accrued liabilities even though payable more than one year from date." Coastal says that the taxes accrued on its books will be offset by the first payment of taxes by the consolidated group and therefore will be paid. The statement in the Uniform System of Accounts, however, has reference to taxes payable; that is, taxes for which Coastal is liable, but Coastal was not shown to be liable for taxes except on the contingency that in some later year a tax would be payable on the basis of the consolidated return. Therefore Coastal has no taxes payable and should

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[10] *Northern Natural Gas Company*, 26 FPC 841.

[11] *Cities Service Gas Co.*, FPC, , Opinion No. 396, Docket No. G-18799, July 15, 1963.

not accrue them. Any other result would be inconsistent with *Cities Service,* where we determined that the tax allowance in a rate case should be a proportional part of the taxes payable on a consolidated basis, while here no tax was shown to be payable on the consolidated returns for the period in question.

Coastal contends further that the decision reached by the examiner and by us here would result in rate decreases to nonjurisdictional customers who are not subject to our jurisdiction. This is because they pay for gas on a cost-of-service basis. Contrary to Coastal's contentions, we are not indirectly trying to regulate the nonjurisdictional sales of the system. We are merely determining an accounting matter that was excluded from the settlement of a rate case. The computation of Florida Gas' rates to its nonjurisdictional customers is a matter for private contracts, and we are in no way attempting to fix those rates. Whether the treatment of the consolidated tax required here will have an effect on jurisdictional rates is not before us for determination.

The Commission further finds:

(1) The $7,936,545 recorded in the plant accounts of Houston Texas over the cost to the above-named engineering and construction firms is a write-up and together with the related amount of $250,565 of interest during construction should be transferred from Account 101, Gas plant in service, to Account 116, Other gas plant adjustments, on the books of Florida Gas Transmission Company.

(2) It is reasonable and appropriate that the write-ups and other improper charges in the plant accounts of Florida Gas Transmission Company of $7,936,545 and $250,565 to be transferred to Account 116, Other gas plant adjustments, be disposed of by a charge to earned surplus, except to the extent of any accrued depreciation applicable to the amounts, which depreciation amounts are chargeable to Account 108, Accumulated provisions for depreciation of gas plant in service.

(3) The accruals for income tax purposes by Coastal now reflected on the books of Florida Gas Transmission Company are in violation of the Commission's Uniform System of Accounts.

The Commission orders:

(A) Florida Gas Transmission Company shall classify the amounts of $7,936,545 and $250,565 included in its plant accounts and referred to in Finding (1) above, in Account No. 116, Other gas plant adjustments, of the Commission's Uniform System of Accounts prescribed for natural-gas companies.

(B) Florida Gas Transmission Company shall dispose of the amounts classified in Account 116, Other plant adjustments, referred to in Paragraph (A) above, as set forth in Finding (2) above.

(C) Florida Gas Transmission Company shall eliminate the accruals by Coastal of the amounts accrued for income

tax purposes included in its Accounts 236 and 409, above referred to in Finding (3).

(D) Florida Gas Transmission Company shall submit within 90 days from the date on which this decision becomes final certified copies of accounting entries effecting compliance with the requirements of Paragraphs (A), (B), and (C) above.

(E) The decision of the presiding examiner is hereby adopted as the decision of the Commission to the extent not inconsistent herewith.

(F) Exceptions not specifically granted are hereby denied.

By the Commission.

Commissioner O'Connor dissenting filed a separate statement appended hereto.

Commissioner Woodward dissenting on the issue of consolidated taxes, consistent with the views expressed in his dissenting statement accompanying Opinion No. 396, issued July 15, 1963 in Cities Service Gas Company, Docket No. G 18799, 29 FPC.

(SEAL)

JOSEPH H. GUTRIDE,
Secretary.

Appendix E—Opinion No. 431 of Federal Power Commission

FLORIDA GAS TRANSMISSION COMPANY

COASTAL TRANSMISSION CORPORATION

Docket No. RP61-3

Docket No. RP61-4

(Issued June 8, 1964)

O'CONNOR, Commissioner, *dissenting*:

A primary issue before the Commission is whether four contracts, dated October 23, 1958, were executed between affiliated companies. I respectfully dissent from the majority's conclusion that they were.

At the threshold of this issue lies two subsidiary issues: First, the appropriate date as of which affiliation is to be tested, and secondly, the proper test to be employed at this date.

It is Staff's contention that the test date should be December 8, 1954, when Houston Texas authorized its Board of Directors to enter into Letters of Agreement with the contracting companies. Florida Gas, however, contends that the legally significant date is October 23, 1958, when the definite contracts were finally executed. Fortunately, this issue was raised, argued, and decided twenty-seven years ago.

Appendix E—Opinion No. 431 of Federal Power Commission

In *Florida Power Corporation*,[1] two contractors (Hardaway), two engineers (Mees) and a fifth party (Winthrop) organized West Florida Power Company to build a hydro-electric project. They later transferred their West Florida capital stock to Central Florida Power & Light in consideration for $175,000 and an agreement "... to employ the Hardaways as contractors and the Mees Brothers as construction engineers, provided the purchasers erected a hydro-electric plant on the Ocklocknee River within 3 years."[2] The agreement and stock were subsequently transferred to the Florida Power Corporation, which controlled West Florida at the time the license was granted.

The Commission was then faced with rendering an "actual legitimate original cost" determination for the project. In reaching this determination, it discussed the propriety of including various cost elements. Only two are pertinent here. The first involved $109,903.61 paid by the licensee to its parent for construction supervision. The Commission reaffirmed its conviction, earlier enunciated in the *Alabama Power Co.* case[3] and *Louisville Hydro-Electric Co.*,[4] that inter-affiliate transactions are to be recorded at cost, and summarily disallowed the supervision fee. The second element, however, involved the fees paid to the Hardaways and the Mees Brothers pursuant to the earlier executed service agreements. Here the Commission refused to invoke the exclusionary rule noting that "... whatever

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[1] 1 FPC 390 (1937).
[2] *Id.* at 392.
[3] 1 FPC 25 (1932).
[4] 1 FPC 130 (1933).

financial interest Mees & Mees had in the licensee terminated *at the time the contract of July 8, 1925 was executed.*" [5]

It then concluded:

> "It is obvious that the terms of the sales contract precluded competitive bidding, . . . A careful study of the record, nevertheless, results in the conviction that, notwithstanding the absence of competitive bidders, the fee paid by the licensee is reasonable." [6]

The obvious holding of *Florida Power* is that affiliation is to be tested at the time definitive contracts are executed, and, absent a showing of affiliation the extent of inclusion will depend upon the reasonableness of the fees. Inasmuch as the Commission had previously decided five litigated Section 4(b) cases involving the "no profits" rule,[7] and invoked the rule in this case, *Florida Power* can hardly be dismissed as a decisional oversight.

Further, the decision is eminently sound. The existence of control is relevant, and should be tested, only at the mo-

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[5] 1 FPC at 406. Emphasis supplied throughout this statement unless otherwise stated.

[6] *Ibid.*

[7] *Clarion River Power Co.*, 1 FPC 269 (1935), *aff'd sub nom. Clarion River Power Co.* v. *Smith*, 59 F. 2d 861 (D. C. Cir. 1932), *cert. denied*, 287 US 639 (1932); *Safe Harbor Water Power Corp.*, 1 FPC 230 (1935); *Louisville Hydro-Electric Co.*, 1 FPC 130 (1933), *aff'd sub nom. Louisville Gas & Electric Co.* v. *FPC.*, 129 F. 2d 126 (6th Cir. 1942), *cert. denied*, 348 US 761 (1942); *Chelan Electric Co.*, 1 FPC 102 (1933), *aff'd sub nom. Alabama Power Co.* v. *McNinch*, 94 F. 2d 601 (D. C. Cir. 1937), *cert. denied*, 317 US 652 (1942). Although these cases were decided under the Federal Power Act, Section 6(a) of the Natural Gas Act likewise empowers the Commission to determine "actual legitimate cost." 52 Stat. 824 (1938).

ment legal obligations to pay become vested, for only at this moment do the interests of ratepayers become involved. These interests had not become involved on December 9, 1954. The Letters of Agreement, signed the day before, obligated Houston Texas to do nothing more than negotiate.[8] Enforceable contracts did not come into being, and the interests of ratepayers did not become involved, until October 23, 1958, when the "affiliates" were no longer in control of either The Houston Corporation or Houston Texas. Consequently, testing for control prior to this date is inappropriate.

Equally inappropriate is the majority's contention that to follow Florida Power would allow those in control of a company to negotiate agreements with their own service firms, leave the company, then later have their firm execute a formal agreement with the company along the identical lines set forth in the initial agreement. Surely if the initial agreement legally bound the company to pay specific fees, affiliation should be tested as of that date. This, however, is not the fact in the instant case.

The second subsidiary issue involves the appropriate test for affiliation. Since the *St. Croix Falls Minnesota*

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[8] The Letters of Agreement typify the "incomplete" and thus unenforceable contract to which Page refers in his definitive study of contract law. 1 PAGE, CONTRACTS §§ 87-89 (2d ed. 1920). As an example, he cites offers "which leave the amount of compensation to be determined by subsequent negotiation, fixing only the extreme limits within which the negotiations are to range." *Ibid.* at 122. See generally, 1 WILLISTON, CONTRACTS, *Making of Offers*, §§ 41, 42 (3rd ed. 1957) and 1963 supplement citing similar illustrations of agreements too indefinite for enforcement.

Improvement Co. case,[9] this test has been undisputed. It requires a finding that the reporting company controls, is controlled by, or is under common control with other companies or persons.

The core determination in this case thus becomes: Did the four companies on October 23, 1958, control Houston Texas.[10] In order to adequately answer this question, the structure of The Houston Corporation, as of this date the sole parent of Houston Texas, must be examined.

The Houston Corporation was formed in 1957 with 600,000 authorized shares. At inception, its capital structure was as follows: the Mack group[11] controlled 23.8 percent of the stock; the engineering and construction group[12] controlled 30 percent; Delhi-Taylor, pursuant to a previous agreement, controlled 13 percent; various investment bankers controlled 10.6 percent; and other interests controlled 14 percent. The Board of Directors was comprised of the following: Mr. F. E. Stanley, Mr. Theodore Rinehart, Mr. C. C. Barnard, Mr. O. Paul Herzig, Mr. Paul C. Wallack, Mr. John M. Harbert, III, Mr. Allen R. Kleinkauf and Mrs. H. S. Mack.[13]

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[9] 3 FPC 13 (1942).

[10] There is no claim that these companies were controlled by, or under common control with, Houston Texas.

[11] Estate of J. O. Mack, Helen S. Mack, Allen R. Kleinkauf, B. M. Kleinkauf, O. P. Herzig and family.

[12] Barnard & Burk, John M. Harbert, III, Midwestern Constructors, Walco Engineering & Construction Company, and Midwestern-Walco.

[13] Mr. Harold A. Martin was elected to the Board at the special meeting on December 14, 1957.

Appendix E—Opinion No. 431 of Federal Power Commission

In June of 1958, however, the acquisition of Coastal Transmission Company from Delhi-Taylor, as well as the consummation of the public financing, caused a structural alteration in The Houston Corporation. Delhi-Taylor now held 48.3 percent of The Houston Corporation stock. The interest of Mr. Barnard, who as of June 1957 held 2.55 percent, fell to .9 percent. The interest of Mr. Harbert, previously 4.7 percent, fell to 3.3 percent. Likewise, the interest of Mr. Wallack and family, previously 4.8 percent, decreased to but 3 percent. The same dimunition was true in the case of Mr. Stanley and family, whose interest went from 6.18 percent to 2.4 percent. Changes in control were reflected in changes in management. At the June 1958 annual meeting, the Board of Directors became composed of Mr. W. J. Bowen, Mr. Leon M. Payne, Mr. Carl M. Mueller,[14] Mr. Harold A. Martin, Mr. Rinehart, Mr. Stanley, and Mr. Barnard.[15] The Board of Houston Texas was likewise reconstituted. As of this date it was comprised of Messrs. Bowen, Herzig, Kleinkauf, Payne, Rinehart, Stanley, and Mrs. Mack.

Consequently, the gist of the majority's opinion is that four companies dominated Houston Texas at a time when: First, six of its seven directors and five of the seven directors of The Houston Corporation were admittedly beyond

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[14] Mr. Mueller subsequently resigned and was replaced by Mr. Felix A. Mulgrew, a Vice President of The Bankers Trust Company on February 15, 1959.

[15] At this time the principal officers of The Houston Corporation were: Mr. Stanley, Chairman of the Board and President; Mr. Bowen, Director and Senior Vice President; Mr. Rinehart, Director, Senior Vice President and Secretary; Mr. Herzig, Vice President-Engineering, and Mr. Kleinkauf, Assistant Treasurer.

their control,[16] and second, the sum total of all their interest was 9.6 percent. I cannot subscribe to this conclusion.

The majority's error lies in its confusion of "lack of arm's length bargaining," which may have existed in this case, with "affiliation," which surely did not. "Lack of arm's length bargaining" may include "affiliation" but it does not necessarily include it. "Lack of arm's length bargaining" is a general term; all it requires is that a contract be executed under conditions of collusion, fraud, gross neglect or undue influence. In such event, the reporting party then has the burden of justifying the reasonableness of its claimed costs. Any costs in excess of what is determined to be reasonable are disallowed. "Affiliation," however, is a word of art. If affiliation is found, any profit paid is summarily disallowed and the reasonableness of the profits is irrelevant. Affiliation, however, requires a very specific finding; namely, that as of the date of the execution of a contract, one of the parties controlled, was controlled by, or was under the common control with, the other party. As applied to the instant case: it means that the four parties not only had the power to execute the October 23 contracts under any terms they desired, but that they also, at this date, possessed the power ". . . to direct or cause the direction of the management and policies of [The Houston Corporation] . . ."[17] This requirement demands by its

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[16] Tr. 1598. Staff Witness Heim admitted that no control existed as to Messrs. Bowen, Payne, and Rinehart. Three other directors, Messrs. Herzig and Kleinkauf and Mrs. Mack were never considered to be controlled by the service firms.

[17] Section 5(b) of the Uniform System of Accounts, defining "control."

very terms that these four companies have complete control over every phase of corporate management as of October 23, 1958. Not even Staff has asserted that control existed to this extent, but without it the whole claim of affiliation must fall.[18]

The majority's contention that *St. Croix* can be satisfied with less than this, and that the "no-profits" rule was designed to preclude all insider profits, is an overstatement. Its principle was not "no profits to insiders:" but "no profits to *controlling* insiders," and it was developed to prevent holding companies from compounding profits in inter-corporate transactions. The rule recognized the fiction of treating corporations, dominated by a common parent, as separate. It also recognized that only with this dominance could they be said to be but one corporate entity. This is revealed by examining the corporate relationship to which the rule was applied. It is also revealed by comparing the rule, as enunciated in *St. Croix,* with true "no profits to insiders" rules such as Section 12 of the Natural Gas Act, Section 305(a) of the Federal Power Act, and Section 2(a)(11)(A)-(D) of the Public Utility Holding Company Act of 1935.[19]

The distinction between "affiliation" and "lack of arm's length bargaining" is not an exercise in academic hair-splitting. It is both substantive and significant, and is supported by the legal history of the "no-profits" rule.

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[18] *Cf., Detroit Edison Co.* v. *S.E.C.,* 119 F. 2d 730, 738-39 (6th Cir. (1941), *cert. denied* 314 U.S. 618 (1941), defining "control" under a less stringent statute than Section 5(b).

[19] 49 Stat. 804 (1935).

Appendix E—Opinion No. 431 of Federal Power Commission

The inception of the rule is often recognized as *Smith* v. *Illinois Bell Tel. Co.*,[20] where litigation arose over rates set for Illinois Bell Telephone by the Illinois Commerce Commission. In dispute were several cost items including payments made to the Western Electric Company for equipment. Ninety-nine percent of the stock in Western Electric, as was 99 percent of the stock in Illinois Bell, was owned by American Telephone & Telegraph. Thus, American Telephone & Telegraph was in a position to exercise complete control over every phase of the Illinois Bell and the Western Electric operations. In reversing and remanding for additional findings, the Supreme Court noted:

> ". . . Western Electric Company, through the organization and control of the American Company, occupied a special position with particular advantages in relation to the manufacture and sale of equipment to the licensees of the Bell System, including the Illinois Company, that is, that *it was virtually the manufacturing department for that system*, . . ."[21]

The Smith case was relied on two years later in *Western Distrib. Co.* v. *Pub. Serv. Comm'n of Kansas.*[22] Here Cities Service Gas Company was selling gas to Western Distributing Company at the city gate of El Dorado, Kansas. The two companies were under the common control of Cities Service Company, a once removed holding enterprise. Western Distributing Company had filed for a rate in-

[20] 282 U.S. 133 (1930).

[21] *Id.* at 153.

[22] 285 U.S. 119 (1932).

crease, and a question arose over the reasonableness of the 40¢ per Mcf paid to Cities Service Gas Company. Western argued that inasmuch as the rate was charged in interstate commerce its reasonableness was beyond the scope of inquiry of the Kansas Commission. The Supreme Court rejected the contention saying:

> "Having in mind the affiliation of buyer and seller and the *unity of control* thus engendered, we think the position of the [Commission] is sound, . . . Those in control of the situation have combined the interstate carriage of the commodity with its local distribution in *what is in practical effect one organization.*" [23]
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> "All of these facts so averred in the pleadings would be far more persuasive with respect to the propriety of the rate if the parties were independent of each other and dealing at arm's length. *Where, however, they constitute but a single interest and involve the embarkation of the total capital in what is in effect one enterprise,* the element of double profit and the reasonableness of inter-company charges must necessarily be the subject of inquiry and scrutiny before the question of the lawfulness of the retail rate based thereon can be satisfactorily answered." [24]

Thus, in both *Smith* and *Western,* the inter-corporate relations were entirely different from those currently before us, for in both cases corporate control vested elsewhere than

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[23] 285 U.S. 124.

[24] *Id.* at 126.

in the managerial discretion of the reporting company. Consequently, a finding of affiliation was unquestionably correct.

The following year the Commission rendered its decision in the *Louisville Hydro-Electric Co.*[25] case, clearly the most expositive and well-reasoned of all Commission opinions dealing with the rule.[26] The question presented was whether a 7½ percent fee paid to the Byllesby Service Company, affiliated to the licensee through the intricate H. M. Byllesby Company corporate lacework, was properly includable in the "actual legitimate original cost" of the project. A brief discussion will sufficiently portray the circumstances in which the rule was meant to apply, and distinguish those circumstances from the ones presently before us.

The Byllesby Service Company was the managing, directing, constructing and servicing agency of the entire sys-

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[25] 1 FPC 130 (1933), *supra* note 7.

[26] Prior to *Louisville*, the Commission had rendered two decisions dealing with the no-profits rule. The first was *Alabama Power Co.*, 1 FPC 25 (1932), which involved the propriety of including a 3 percent fee paid to the Dixie Construction Company, an affiliate of the licensee. Affiliation existed at the time construction commenced because Alabama Power solely controlled Dixie. Five months later, however, Alabama Power transferred Dixie to Winona Coal Company. Winona was under the sole control of the Traction Company, which also solely controlled Alabama Power. Further, Alabama Power and Dixie shared common officers and directors. Thus, affiliation was properly found and the fee disallowed. The second case was *Chelan Electric Co.*, 1 FPC 102 (1933). There American Power & Light had lent money to the licensee, its wholly owned subsidiary, at 7 percent, the legal rate in the state wherein the project was located. The Commission properly held that due to the degree of control, affiliation existed and the cost of the money to the parent, and not the legal rate, should control the amount included in the licensee's rate base.

tem, and officers and directors were completely intertwined into every branch. Thus, the vice president who signed the contract for Byllesby was at the same time director, assistant secretary and assistant treasurer of the licensee. He was, further, vice president and assistant secretary of the licensee's immediate owner, the Louisville Gas & Electric Company of Delaware, as well as a director, secretary and treasurer of the Standard Company, which controlled Louisville Gas & Electric. Further, the signator for the licensee was, while being its vice president, also a director in both Louisville Gas & Electric and the Standard Company. The contract's attestor was an assistant secretary in all four companies.

The control exercised by Byllesby was not limited to the execution of contracts. It drafted the licensee's articles of incorporation. It prepared, filed, and ramrodded the application before this Commission for a license. After the license was granted, Byllesby then negotiated and consummated the financing, purchasing, construction, and inspection. It also did most of the accounting and legal work, for all of which it made extraordinary profits.[27] The Commission noted, however, that for these profits Byllesby made no investment and it took no risk. It purchased materials and supplies for the licensee's account, and it received a cost-plus return. Further, as the finances of the licensee were under system control, it had no losses due to bad debts, delays in collecting, lawsuits or disputes.

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[27] A Federal Trade Commission audit, entered into the record, revealed that for the years 1922-1927, Byllesby's net income was $10,794,953.17, representing a profit of 98.5 percent.

Appendix E—Opinion No. 431 of Federal Power Commission

With these facts before it the Commission began its total denunciation of the H. M. Byllesby Company system in general, and of the fee contract where involved in particular.

The Commission pointedly commented on the licensee's freedom of action:

> "Upon these admitted facts there is no room for quibble or doubt that licensee has no independence of action, but that decisions made by licensee operating company and the Byllesby Service Co. were made by the same group of men, acting in dual, triple, and quadruple capacities, responsive primarily to the holding and controlling interests. This corporate 'family' control was so complete in fact and limited in personnel as to require but 1 room, 1 table, 1 small group of men at 1 point of time to dictate on behalf of the *pater familias* an offer by 1 member and an acceptance by another." [28]

Of the contract there in issue, the Commission said:

> "The service contract in question is monopolistic, requiring the exclusive employment by the operating company of the Byllesby Service Co. for a term of 10 years, and provided for a profit to be paid by licensee, a public utility, for the benefit of a private holding company, into whose treasury every dollar of the profits extorted from the operating company is siphoned through the holding company's wholly owned service company. So complete was the reliance on this control, the contract for the construction service, running into several millions of dollars

[28] 1 FPC at 135.

> was not entered into until April 15, 1926, prior to which time a large amount of the work for which this fee is claimed had already been done. Contrary to business custom, the officers and directors of the licensee, acting in their capacity, for that company found it unnecessary to have the contract in advance of beginning work to guard against misunderstanding or unreasonable and arbitrary charges, since they were dealing with themselves under the guise of another corporation. To ask the Commission to find that in the making of this fee contract there was any arm's length bargaining, or real independence of action on the part of the licensee, assaults the credulity of the Commission beyond reason." [29]

Numerous other Commission decisions have held the no-profits rule to be applicable,[30] but their detailed discussion would be both repetitive and anticlimactic. It is sufficient merely to note that in every instance the affiliate possessed the power, although that power was not always fully exercised, to totally dominate the managerial policies and decisions of the reporting company. In no instance was a contention of affiliation successfully asserted where the claimed

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[29] *Id.* at 135-6.

[30] *Colorado Interstate Co.* v. *F.P.C.*, 324 U.S. 581 (1945); *California Oregon Power Co.* v. *F.P.C.*, 150 F. 2d 25 (9th Cir. 1945) *cert. denied*, 326 U.S. 781 (1946); *Pennsylvania Power & Light* v. *F.P.C.*, 139 F. 2d 445 (3rd Cir. 1943), *cert. denied*, 321 U.S. 789 (1944); *Louisville Gas & Elec. Co.* v. *F.P.C.*, 129 F. 2d 126 (6th Cir. 1942), *cert. denied*, 318 U.S. 761 (1942); *Alabama Power Co.* v. *McNinch*, 94 F. 2d 601 (D. C. Cir. 1937), *cert. denied*, 317 U.S. 652 (1942); *Pacific Power & Light* v. *F.P.C.*, 134 F. 2d 602 (5th Cir. 1943); *Minnesota Power & Light*, 3 FPC 388 (1943); *Puget Sound Power & Light*, 3 FPC 231 (1942); *Northwestern Elec. Paper Co.*, 3 FPC 83 (1942), affirming 2 FPC 327 (1940).

affiliate possessed less than this power. Nor should it have been, not only because a lesser showing would have violated the *St. Croix* test, but also because it would not have equitably supported the drastic consequences necessarily flowing from a finding of affiliation: complete deletion from plant accounts, and, if the finding is made at certification proceedings, disallowance to the companies of any profit.

Reaching the conclusion that no affiliation, either as defined in *St. Croix* or as found in any previous case, existed between Houston Texas and the four interested parties is not determinative of the question of how much profit is properly includable in Houston's plant accounts. As clearly stated in *Pennsylvania Power & Light Co.*, we have a regulatory obligation to test the reasonableness of all claimed costs:

> "The word 'legitimate' does involve an element of reasonableness. A claimed cost may be so in excess of the cost of comparable construction or purchase that it raised a question of collusion, fraud or gross neglect which would cast on the licensee the burden of proving the circumstances which would justify the claimed cost, and in the absence of such proof the claim in excess of what is reasonable should be disallowed." [31]

Such questions are, admittedly, raised by the instant facts and thus the last question becomes: Were the profits paid by Houston Texas reasonable?

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[31] 3 FPC 89, 119 (1942). Although the Commission was here defining the word "legitimate" as used in the Federal Power Act, their interpretation would apply equally to Sec. 6(b) of the Natural Gas Act. See note 7 *supra*.

Appendix E—Opinion No. 431 of Federal Power Commission

In answering this, two analyses, must be made: First, did the contracts, under which the profits were made, contain standard industry compensatory provisions; and secondly, as a check reference, how did the final costs compare with relevant industry costs?

Industry compensatory clauses are of two varieties. One is a cost-plus provision, which repays the contractor his total construction costs plus either a fixed percentage return on those costs or a lump sum. These provisions insulate the contractor from substantially all risks. In every Commission case applying the no-profits rule, the cost-plus, no-risk method of compensation was employed.

The second method is the fixed-unit method. Here a construction project is either quantitatively or qualitatively categorized into work units which are then prescribed standards of construction and bases of payment. Under this method, the entire risk attendant to bad weather, labor disputes, geological difficulties and rising construction costs fall on the contractor. Assuming no outrageously high unit payments, he is assured of no profit. Contractors can minimize this risk by the inclusion of escalation clauses whereby increased costs are absorbed by the builder. There were no such clauses in any Houston Texas contract. Specifically, Section 7.2 provided:

> "It is understood that the unit prices enumerated in the Contract cover and include all of the compensation to be received by Contractor from Company for furnishing necessary materials, labor, tools and equipment, and for performing all work contem-

> plated and embraced under the contract; all overhead, superintendence, labor, use of equipment; all loss or damage arising from the nature of the work or from action of the elements or from any unforseen difficulties which may be encountered during the prosecution of the work until the final acceptance by the Engineer; all risks of every description connected with the prosecution of the work; and all expenses incurred in consequence of the suspensions or discontinuance of the work as herein specified and for completing the work according to the Plans and Specifications."

The contracts entered into by Houston Texas all included this type of compensation provision.[32] Consequently the contracts were, on their face, clearly reasonable.

Although the ambiguous language of Opinion 301 is open to various and conflicting interpretations, one fact is clear: At the time the opinion was rendered, the cost estimates were reasonable.

> "Houston Texas has likewise presented evidence pertaining to the engineering feasibility and cost estimates of the project. As to the latter, the evidence supports a finding that its cost estimates for materials and construction compare favorably with present-day costs experienced by other pipeline companies and are reasonable." 16 FPC at 129.

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[32] Except for Barnard & Burk who were to receive 1 percent of the cost of all pipeline work up to and including $60,000,000 and ¾ percent of the cost in excess of $60,000,000. They were also to receive 2 percent of the cost of compressor stations, meters, regulator stations, and employee housing facilities. A subsequent agreement set the maximum fee at $865,000.

The final prices resulting from these contracts likewise appear to be reasonable. The Coastal Transmission Corporation mainline, a suitable check reference, supports this conclusion.

Concurrent with Houston Texas beginning its construction of the 24-inch Baton Rouge, Louisiana-Florida mainline, Coastal began construction of a similar mainline from Mission, Texas, to Baton Rouge. For the most part, it traversed terrain substantially more amenable to excavation and pipe laying than that crossed by Houston Texas. Consequently, if the unit costs of Florida Gas approximate those of Coastal, which have already been reviewed and approved by the Commission staff, they must be allowed to stand.

Evidence reveals that Houston Texas' unit prices not only approximated Coastal's they were uniformly cheaper. Thus, the unit cost per foot for the 24-inch mainline (which represented 63 percent of Coastal's total facility cost and 74 percent of Houston Texas') was $4.391 for Coastal and $4.363 for Houston Texas. Houston Texas' installation cost per horsepower of $69.39 was likewise cheaper by $3.49.[33] This same relationship was true for rural laterals; Coastal's cost per diameter inch per lineal foot ran 22 cents, while Houston Texas' was only 20.1 cents. Although substantial expert testimony pertinent to the reasonableness of Houston Texas' costs was unfortunately excluded by the Presiding Examiner, and although close scrutiny may have revealed that the Houston Texas mainline could have been

[33] The completed compressor station cost for Houston Texas ($309.00) ran slightly higher, however, than that for Coastal ($293.00).

more economically constructed,[34] I am persuaded that these costs are not unreasonable. Consequently, I would allow the totality of the profits to remain, as they are now, in the Houston Texas plant accounts.

I conclude by noting that the majority's error of law is compounded by their error of judgment. I have serious apprehension that their decision, which negates the previous definition of affiliation and extends the no-profits rule into an undelineated area, will only have a deleterious effect on the public interest.

This interest has often been served by projects which were the creative progeny of but a few promoters. These promoters, lacking the vertical integration of large companies, were forced to incorporate with scattered interests in order to metamorphose idea into actuality. As was only logical, representatives for these interests often became officers or members of the board of the infant corporation.

Their financial insignificance, however, when coupled with the uncertain prospects for remuneration, made investments of time and capital a substantial risk. As compensa-

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[34] The fact that a project could have been more cheaply constructed does not, *per se,* make its costs unreasonable.

> "The Commission has carefully reviewed the testimony of all the witnesses with reference to the cost of cutting trees in the pond area, and piling and burning same, *and while there is evidence in the record that this work might have been more economically accomplished, the record shows that the money was* actually spent and paid, and the work done by local contractors or labor employed in the locality of the project on the best terms that licensee secure. Upon these facts shown by the record, the Commission approves the total expenditures. . . ." *Florida Power Corp.,* 1 FPC 390, 398 (1937).

tion, they were oftimes given stock options, and, in addition, the right to the construction contracts, at reasonable prices, in the event the project was ultimately certificated. These were the only terms upon which they would consent to invest, and consequently, the only terms under which these valuable projects could have been built.

The day of the pooled-interest project is thus over. This decision will insure projects either being constructed by organizations sufficiently large to absorb the potential loss, or else remaining unconstructed. Neither alternative, I submit, is either dictated by or commensurate with the public interest.

* * * * *

Completely aside from my belief that no affiliation within the definition of *St. Croix* exists in this case, there is still another equally persuasive reason why the plant accounts should remain untouched.

Since passage of the Natural Gas Act in 1938, this Commission has repeatedly appeared before Congress for remedial legislation. Although in every instance the plea was made that without congressional assistance we would be ill-equipped to discharge our entrusted responsibilities, the most significant request ever made, or granted, was that which led to the 1942 amendment of Section 7. As originally enacted, Section 7 gave the Federal Power Commission certificate jurisdiction only over facilities used to transport interstate gas to a market already being served by another natural gas company. It was immediately ap-

parent that this was a severe jurisdictional limitation.[35] In order to remedy it, Congress was requested to amend Section 7(c) so as to give us certificate jurisdiction over all interstate facilities and, as a concomitant power in a proposed Section 7(e), the power to condition those certificates as the circumstances required.

Thus, in June of 1941, Chairman Olds wrote a letter to Representative Clarence F. Lea, Chairman of the Committee on Interstate and Foreign Commerce on H. R. 4819, the proposed amendment to Section 7. In his letter, Chairman Olds stated:

> "Adequate regulation is obviously not provided unless the Commission has jurisdiction to regulate the construction of the pipeline and control its initial financing as well as to regulate its operation after construction. By the unregulated construction of the pipeline, the public interest may be so disregarded that proper regulation of operation thereafter may prove a difficult matter or may be practically impossible because the construction of the line is uneconomic or costs are inflated. *Regulation should begin with construction of the line, not with operation after construction.*"

H.R. 4819 ultimately became H.R. 5249 which was discussed before the House Committee in July of 1941. At this time, Commissioner Manly further supplemented the above statement of Chairman Olds.

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[35] *E.g., Western Natural Gas Company,* Docket No. G-168, and *Independent Natural Gas Company,* Docket No. G-178. (Consolidated into order issued 2 FPC 910 (1941) which dismissed, for want of jurisdiction, applications for certificates of public convenience and necessity to serve the Wisconsin market.)

Appendix E—Opinion No. 431 of Federal Power Commission

"Commissioner Manly . . . .

"Now, what the Commission does under ordinary conditions is to require those conditions to be set forth in the authorization for a certificate that is accepted by the company as a condition precedent to the actual issuance of the certificate, so that in all intents and purposes the company has a right to reject a certificate containing any conditions which are unreasonable, onerous, or have no relevancy to the issue."

"Mr. South. That is what I have in mind. If they are too burdensome, then the application could be withdrawn."

"Commissioner Manly. They could come back before the Commission and ask for a rehearing if they regard the terms and conditions as being onerous."

"Mr. South. As a general proposition, you would say that this is exercised in the public interest for the purpose of broadening the service sought to be rendered; would you go that far?

"Commissioner Manly. I would not quite agree with the latter. *It would be primarily for the purpose of making explicit the conditions under which the certificate is being issued.*"[36]

Some three months later, the bill favorably reported out of committee with the following introduction:

"The bill when enacted will have the effect of giving the Commission an opportunity to scrutinize the financial set-up, the adequacy of the gas reserves,

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[36] *Hearing Before the House Committee on Interstate and Foreign Commerce*, 77th Cong., 1st Sess. (1941).

> the feasibility and adequacy of the proposed services, and the characteristics of the rate structure in connection with the proposed construction or extension *at a time when such vital matters can readily be modified as the public interest may demand.* Without such authority, the Commission may find itself confronted with a situation where it must either accept conditions which appear undesirable in the public interest, *or require, subsequent to construction, changes which may have much more serious practical consequences than they would have had if they had been made before the public was asked to finance the enterprise.*" [37]

The amendment was passed the next year.[38]

Given this congressional sanction, the Commission enacted Part 157 of its Regulations. This specifies, in detail, the information required to be filed with certificate applications and is designed to fully apprise the Commission as to whether a project will, in fact, be in the public interest. The filing is recognized as a "forthright obligation of the applicant," [39] and, as Part 157(c) makes clear, the Part will be strictly applied in all applications.

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[37] *House Committee on Interstate and Foreign Commerce Report No. 1290 on Amendments to Section 7 of the Natural Gas Act,* 77th Cong., 1st Sess., pp. 2-3 (1941).

[38] Our facility jurisdiction under the Federal Power Act is decidedly narrower. There our certification authority is limited to generating facilities which occupy Government lands, navigable streams, or streams which affect interstate commerce. Consequently, we have neither the opportunity nor the obligation to examine, prior to construction, the costs of projects to be located elsewhere even though the resulting energy is to flow in interstate commerce.

[39] Part 157.5(b).

Appendix E—Opinion No. 431 of Federal Power Commission

One of the most significant of the Part 157 requirements involves the filing, under sub-Parts 157(a)(4)[40] and 157(a)(15)[41], of detailed information concerning any corporate or financial relationships that may exist between the applicant and other persons. The relevance of this information to a section where certificates are granted only if they are in the public interest is clear: such relationships can detrimentally affect this interest and thus, before a certificate should be issued, these relationships should be analyzed in a detail commensurate with that imposed upon

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[40] "(4) Exhibit D—Subsidiaries and affiliation. If applicant or any of its officers or directors, directly or indirectly, owns, controls, or holds with power to vote, 10 percent or more of the outstanding voting securities of any other person or organized group of persons engaged in production, transportation, distribution, or sale of natural gas, or of any person or organized group of persons engaged in the construction or financing of such enterprises or operations, *a detailed explanation of each such relationship,* including explanation of each such relationship, including the percentage of voting strength represented by such ownership of securities. If any person or organized group of persons, directly or indirectly, owns, controls or holds with power to vote, 10 percent or more of the outstanding voting securities of applicant—*a detailed explanation of each such relationship.*"

[41] "(15) Exhibit M—Construction, operation, and management. A concise statement setting forth arrangements for supervision, management, engineering, accounting, legal, or other similar service to be rendered in connection with the construction or operation of the project, if not to be performed by employees of applicant, including reference to any existing or contemplated agreements therefor, together with:

(i) A statement showing affiliation between applicant and any parties to such agreements or arrangements. See Exhibit D, paragraph (a) (4) of this section.

(ii) Conformed copies of all construction, engineering, management, and other similar service agreements or contracts in any way operative with respect to construction, operation, or financing of facilities which are the subject of the application or will be applicable under system operations.

the applicant. Following this analysis, a clear, concise decision should be rendered as to whether a relationship existed which would bring any fee payments within the no-profits rule. This is the bare minimum to which applicants are entitled.

There is no doubt that the applicants in G-9262 complied with sub-Parts 157(a) and 157(a)(15). They fully disclosed all financial and corporate relationships existing between the "affiliate" companies and Houston Texas, the proposed contractual arrangements, and the project's estimated cost. Moreover, the applicants explained this information in detail at the hearing.[42] In the event this mass of testimony was overlooked, Green's Fuel, intervenors in Docket No. G-9262, placed the Commission on notice to a possible affiliation issue with the following statement:

> "The evidence is clear and undisputed that Houston proposes to let contracts to insiders without competitive bidding for the construction of the line and compressor stations, as well as a supervision and engineering contract."[43]

If this were not enough, a statement of the relevant relationships, as well as concise statements of Houston Texas' intent to enter into contracts with the construction and engineering groups, appeared in their plan of financing, submitted on July 1, 1958, and approved on August 7, 1958. Thus, at three stages of the certification proceedings—prehearing, hearing, and post-certification—the Commission

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[42] *E.g.*, pp. 7363, 7369, 7592-93, 7596-98, 7600, 7602-4, 7608.

[43] Brief for Intervenor, Docket No. G-9262.

had full knowledge of every fact which it now relies upon to substantially alter its original order of December 28, 1956.

What response did the Commission make to this voluminous evidence? Just this: Out of a 29-page opinion, it devoted *one sentence* to an issue that inevitably became, eight years later, the subject of intense, expensive litigation involving almost 6 percent of a company's plant account. This minusclue consideration read:

> "While as we have already stated, the cost of the proposed facilities appears to be reasonable, in view of [the proposed contractual arrangements], this cost will be carefully scrutinized in any future proceeding dealing with accounting or rates of Houston Gas." [44]

The sentence is classically vague. What does it say? Does it say that the disclosed costs were acceptable and only future additions would be scrutinized? Does it say that the *total* project cost would be later scrutinized? What does "scrutinized" mean? Examined again for "reasonableness," which was already found to exist as to the then-known costs, or examined to delete affiliate profits, when all the facts relevant to this issue were then known? Whatever this sentence says, it does *not* say that "we have carefully reviewed the relevant corporate relationships existing between Houston Gas and the construction and engineering firms and find that the fees, proposed to be paid to these firms, will (or will not) come within the 'no profits to affiliates rule.' "

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[44] 16 FPC 118, 142 (1956).

Appendix E—Opinion No. 431 of Federal Power Commission

It seems incredible that a Commission, which fought so hard for the power to condition certificates, should have then paid it such lip service. Forgotten were the words of Commissioner Manly, whose advocacy over considerable opposition led to the passage of Section 7(e), that the conditioning power "would be primarily for the purpose of making explicit the conditions under which the certificate is being issued."[45] Discarded was the principle that jurisdiction—here to impose conditions—must carry a commensurate obligation—to impose them at the earliest times. There is little doubt that the obligation exists. Recognizing it, the Supreme Court recently noted that the significance of Section 7(e) is that it gave the Commission conditioning power " . . . *at a time when such vital matters can be readily modified as the public interest may demand.*" (Emphasis in original.) The Court went on to state:

> "Clearly, the Commission was given the power to lay down conditions precedent to the entry of natural gas in interstate commerce. Moreover, the Commission has long recognized this obligation and has required modification of many tariff and contract provisions as a condition to the granting of a certificate."[46]

By failing to state an affirmative position on the affiliate fee issue, the Commission undoubtedly lulled both the ap-

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[45] *Supra,* note 36.

[46] *F.P.C.* v. *H. L. Hunt,* 84 Sup. Ct. 861, 868 (1964), quoting the *House Committee Report on Interstate and Foreign Commerce No. 1290.* This principle was reiterated in *F.P.C.* v. *Texaco,* 84 Sup. Ct. 1105 (1964).

plicants and subsequent investors into the mistaken belief that the fees, thrice disclosed, were legitimate plant account inclusions. Without this belief, this valuable line could never have been financed: the rate base reductions resulting in decreased returns—from an already marginal project—would have made it too assuredly speculative to attract prospective investors.[47] It is the investors, specifically, the holders of the 5,323,672 outstanding common shares comprising a total equity of $48,724,432, which today's order detrimentally affects. These shareholders, currently saddled with a retained earnings deficit of $5,265,673, will now suffer an increase in this figure to almost $13,500,000 and a decrease in their total equity of almost 16.5 percent. The total result will be to postpone needed expansions, lower Florida Gas' bond rating, further decrease the attractiveness of its common stock, and increase the cost of its money. All of this, of course, will be reflected in higher gas rates.

We have repeatedly stated that our certification implies no guarantee that a project will operate profitably. This disclaimer does not diminish our responsibilities to the general public, including the investing public, to completely

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[47] There is no controversy over the public benefits derived by the line. First, the Florida Railroad & Public Utilities Commission supported the company's position. It noted ". . . Florida Gas has contributed tremendously to the economy and welfare of the State." Exceptions of Intervenors, p. 15. The Florida Commission exercises jurisdiction over the twelve distributor customers of Florida Gas which, in turn, serve 230,000 customers, and the two electric company customers which serve 1,202,000 customers. Secondly, the customers of Florida Gas all supported its position (Record, Vol. 5, pp. 616-19) and adopted a resolution on December 12, 1962, so stating. Brief of Intervenor, Appendix B.

dispose of any legal issue raised at the time of certification. We certificate with full knowledge that anything less than complete disposition will be interpreted as tacit approval. This obligation was undiminished in the present case by the presence of a *caveat,* if it can be so graced, obscured deep in the confines of The Houston Corporation stock prospectus issued a year and a half subsequent. Page 22 of that prospectus contained the statement that "[t]he Federal Power Commission has made no determination as to the proper rate base for Coastal or Houston Texas or allowable rate of return thereon (except during the development period to the extent stated under 'Agreements Between Coastal and Houston Texas')." The following sentence said "[t]he Federal Power Commission has determined the rate base of other natural gas companies to be the original cost of the property used or useful in the transportation of natural gas for resale . . ., less depreciation plus a reasonable allowance for working capital." Inasmuch as there was no indication that the rate base properties were not "useful in the transportation of natural gas in interstate commerce," nor any mention of the "no-profits rule" as a principle of exclusion from rate bases, the utility of the *caveat* was substantially diminished. This obligation is also undiminished by the recitation of any legal touchstone concerning an overall obligation to consumers. Our moral and legal duty to fully apprise industry applicants of the grounds upon which they are offered a Section 7 certificate, prior to their detrimental reliance thereon, must remain inviolate.

Appendix E—Opinion No. 431 of Federal Power Commission

In my view, this case falls squarely within that envisioned by the Oregon Supreme Court when it said:

> "The doctrine of 'equitable estoppel' or 'estoppel in pais' is that a person may be precluded by his . . . silence, when it is his duty to speak, from asserting a right which he otherwise would have had."[48]

Consequently, I would hold that this Commission is estopped to expunge now, eight years after the issue was appropriately raised by the applicants but deferred by an either indifferent or indecisive Commission, the questioned fees from the applicant's plant accounts.

Consistent with my dissent in the previous *Cities Service* case, I also dissent to the majority's treatment of the consolidated tax issue.

/s/ L. J. O'Connor, Jr.
L. J. O'Connor, Jr., Commissioner

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[48] *Marshall* v. *Wilson*, 154 P 2d 547, 551-52 (1945). For cases holding the doctrine of equitable estoppel applicable against governmental agencies see 2 Davis, Administrative Law, § 17.03 (1958) and 1963 Supplement.

APPENDIX F

Opinion No. 431-A of Federal Power Commission

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners:

Joseph C. Swidler, Chairman; L. J. O'Connor, Jr., Charles R. Ross, Harold C. Woodward, and David S. Black.

Florida Gas Transmission Company Docket No. RP61-3
Coastal Transmission Corporation Docket No. RP61-4

OPINION No. 431-A

OPINION AND ORDER DENYING REHEARING

(Issued August 5, 1964)

SWIDLER, Chairman

Florida Gas Transmission Company and the Florida Public Utilities Commission on July 7, 1964 filed applications for rehearing of our Opinion No. 431 and accompanying order issued June 8, 1964. There we found that $7,936,545 representing profits of four affiliated engineering and construction firms, along with the related amount of $250,565 of interest during construction, should be eliminated from Florida Gas' plant accounts. We also found that accruals for income tax purposes on the books of the predecessor Coastal Transmission Corporation were improper because there was no tax liability for the corresponding period on the basis of the consolidated tax return. In general the issues are treated in our original opinion,

and no purpose will be served in repeating our discussion except for the comments below.

Florida Gas contends that we have promulgated new and different criteria and to the detriment of the company have applied them to facts that had occurred at a time when the former criteria governed. In our opinion we have not adopted a new rule but have applied an old rule to new circumstances. For instance, Florida argues that "the no-profits-to-affiliates" rule has always required a finding of "control" and that such control must exist at the time of the execution of the contracts which created the costs. Without defining the limits reached by the earlier cases, in the present case based on the circumstances discussed in our original opinion we found (mimeo p. 6) that the construction and engineering group though never in a position of legal control in the sense that they had majority stock control, from the beginning occupied a dominating position which as a practical matter precluded any independent action to give the principal construction and engineering assignments to anyone else so long as the inside group's bids were not grossly out of line. The circumstances shown in the record and discussed in our opinion traced the continuing effect of this control up to the period when the contracts were actually executed.

Assuming that in so holding, our opinion expressed a new rule for determining whether to exclude the profits of affiliates this does not invalidate it. In numerous cases unnecessary to cite here courts, while reluctant to proceed retroactively, have applied new rules of law to past transactions. As said in *S.E.C.* v. *Chenery Corp.*, 332 U.S. 194,

203, cited by Florida Gas, "Every case of first impression has a retroactive effect, whether the new principle is announced by a court or by an administrative agency." The court added: "But such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law."

In the present case the "mischief" is permitting the plant accounts of the company to be distorted by this kind of cost, so that there will be little choice in a rate case but to require the consumers of the gas to pay a return on insiders' profits for the expected life of the property. Furthermore, as stated in our original opinion, the language of the Commission's Opinion No. 301 (16 FPC at p. 142), regardless of differences of opinion as to its meaning, at least should have raised a question in the minds of the promoters of Florida Gas or its predecessors as to the treatment that might be accorded the profits item.

Florida Gas argues that there was no basis on which to find that the engineering and construction firms formed an "affiliated group." We did not find, nor did we need to find, that they agreed with each other or that they were formally affiliated with each other. The four firms were affiliated with Houston Texas or its predecessor, and the records make clear that they combined their talents and financial resources to promote the pipeline project not only as investors but also as persons having special interests in the profits to be made from the pipeline's construction. While

Florida Gas points out that the original organizer, Mr. J. O. Mack, negotiated separately with representatives of the several firms, these negotiations were at arms-length, if at all, only to the extent Mack may have had some original control as to which persons he would select from those approaching him with an interest in construction and engineering profits from a successful pipeline. Once the representatives of the several firms had become members of the promotional group further relationships were not at arms-length. The Houston Texas board could as a practical matter not repudiate the oral agreements and, as related in the original opinion, the influence of these early relationships carried forward to the execution of the formal contracts four years later.

Both the Florida Commission and Florida Gas argue that we were in error in citing language in the *St. Croix* case, 3 FPC 13, 21, to the effect that it is impossible to determine what is reasonable cost where an affiliation exists. They point out that evidence was presented in this case that would have enabled us to determine the reasonableness of the pipeline costs. We cited the *St. Croix* case to show the infirmities which exist in any attempt to determine costs where the relationship between the parties is one of affiliation. Actually such evidence is irrelevant and was properly stricken by the examiner. Once the affiliation is established, the profits of the promoters of the project do not represent cost at all, and for this we cited *Louisville Hydro-Electric Company*, 1 FPC 130, 133.

Florida Gas also argues that the $7,936,545 in profits which we deleted from its plant accounts should have been

reduced by the amount of the Federal income taxes on these profits. Obviously if we disallow the entire profit of the affiliated contractor we cannot allow as a cost a portion of that profit which was paid in Federal income taxes. If Florida Gas' plant accounts should not include profits between affiliates it would indeed be an anomoly to include taxes that have been incurred only because of such profits. Furthermore, we note that Florida Gas did not raise this point in its exceptions, and under section 1.31(c) of our Rules has thus waived it.

Florida Gas finally contends, as does the Florida Commission, that we have misinterpreted the language of Opinion No. 301, particularly the statement by the Commission that: "While as we have already stated, the cost of the proposed facilities appears to be reasonable, in view of this fact, this cost will be carefully scrutinized in any future proceeding dealing with accounting or rates of Houston Gas."

Florida Gas says it made a complete disclosure of the facts and would interpret the Commission's language to mean that the estimated cost of the facilities, including the profits, appears reasonable but in view of the relationships outlined the Commission is going to scrutinize the costs carefully after they are incurred to made sure that the actual costs are, in fact, reasonable. In support of its position Florida Gas has appended copies of affidavits from three former members of the Commission who participated in the issuance of Opinion No. 301, and has asked that the record be reopened to receive these affidavits.

Appendix F—Opinion No. 431-A of Federal Power Commission

The Florida Commission contends that the language is clear and unambiguous and that it is sheer sophistry for this Commission to seek an interpretation that converts the quoted language into a warning that "scrutiny" would be synonymous with "non-acceptance" of amounts in excess of the costs of the engineering and construction firms.

The affidavits submitted by Florida Gas, in general, state that it was not the intention of the Commission when Opinion No. 301 was issued on December 28, 1956, to apply the no-profits to affiliates rule or to warn the applicant that it might be applied later. The affidavits of Chairman Kuykendall and Commissioner Kline state that there was no intention that the rule be applied later; otherwise the opinion would have so stated. Commissioner Connole states his view that the Opinion No. 301 treatment "accorded to these estimated costs, including the estimated profits, as disclosed, would be disposed of if a future proceeding dealing with such matters should ever be before the Commission, but no decision was reached nor warning intended nor recommendation made that such profits should be eliminated from the capital plant accounts—." Chairman Kuykendall was in the majority; Commissioners Connole and Kline dissented, although on rehearing Commissioner Kline joined the majority and Commissioner Connole concurred. The remaining two members of the majority, Commissioners Digby and Stueck, are now deceased.

Affidavits of former members as to the interpretation they intended to be placed on language of Commission opinions is not a customary basis for interpreting Commission deci-

sions and, at least in the circumstances here, we do not think it is proper. As Florida Gas concedes, we cannot inquire into the mental processes of a Commissioner nor ascertain what he considered. *United States* v. *Morgan,* 313 US 409, 422; *Chicago, B & Q Ry. Co.* v. *Babcock,* 204 US 585, 593. There are a number of cases (see 97 CJS 514) including *Covey* v. *American Distilling Company,* 132 F. 2d 453 (CA7) cited by Florida Gas, that accept evidence from a Judge in a prior proceeding as to the matters litigated. Frequently these cases involve the application of the doctrine of *res judicata* to a court judgment where the identity of the issues is a matter of some importance. However, none of the cases called to our attention involves admission of evidence as to what a judge or a Commissioner meant by a full opinion setting forth his determinations and the reasons for them. In somewhat different circumstances the Supreme Court has said that judgment "ought never to be overthrown or limited by the oral testimony of judge or juror of what he had in mind at the time of the decision." *Fayerweather* v. *Ritch,* 195 US 276, 307.

We have before us an opinion which does not in terms even discuss the applicability of the no-profits-to affiliates rule, pro or con. As Commissioner Connole's affidavit indicates, it expressly leaves open for further consideration the entire question. The majority on Opinion 301 found the estimated total costs (including the profits) reasonable for purposes of granting a certificate to the proposed pipeline. For other purposes they left these costs for later scrutiny. See *Coastal Transmission Corp.,* Docket No. G-18338, *et al.,* 26 FPC 677, at 685. Assuming arguendo that one Commission could bind

its successors on a matter of this sort, they did not limit this scrutiny, and they did not say how this scrutiny was to be conducted. The problem of the method and scope of the scrutiny was deferred. The intervenor who had raised the issue in the certificate proceeding could not have contested the failure of the Commission to apply the rule since it had not decided against him. We, of course, express no opinion as to what individual members of the Commission may have thought or intended. The affidavits are an attempt to add something to the opinion that was not there before and cannot be retroactively added to it.

Thus the argument of the Florida Commission that the language of Opinion No. 301 is unambiguous and that the cost of the facilities cannot mean only cost less profits is beside the point, for the language does not define the scrutiny to be applied. Likewise the argument of the Florida Commission that we should have found that Florida Gas had made full disclosure does not affect the result. There is no issue here on this point, and, irrespective of full disclosure, the costs of the pipeline were subject to scrutiny under Opinion No. 301. Our response to the Florida Commission also applies to the dissenting statement of Commissioner Woodward.

Commissioner O'Connor's dissent points to possible losses to investors. Where such losses are the result of insiders' profits, the investors may have legal remedies through the courts, whereas the consumers must depend upon the action of the regulatory bodies having rate and accounting jurisdiction.

Appendix F—Opinion No. 431-A of Federal Power Commission

On the question of Coastal's taxes, Florida Gas continues to argue that Coastal could have accrued taxes on its books although no taxes were payable on the consolidatd return on the theory, apparently, that taxes will be payable in later years. It cites our Uniform System of Accounts Section 7 "Current and Accrued Liabilities" as permitting the accrual of taxes as accrued liabilities even though payable more than one year from date. This section, however, assumes that whenever payable the item constitutes a liability. Here, during the period in question, no taxes were payable on the consolidated return, nor was there any liability incurred for taxes. Therefore Coastal, in accordance with the *Cities Service* case,[1] could not accrue any liability for taxes.

Florida Gas further argues that because of the elimination of the construction profits from cost the company's tax depreciation will be greater than the depreciation allowed on its books for cost of service purposes with a resultant windfall to jurisdictional and nonjurisdictional customers. This is an issue not before us here and will have to be determined in a proceeding affecting Florida Gas' rates. The nonjurisdictional rates appear to be subject to the jurisdiction of the Florida Commission.

The Commission finds:

(1) The assignments of error and grounds for rehearing set forth in the applications for rehearing of Florida Gas Transmission Company and the Florida Public Utilities Commission present no new facts or principles of law which

[1] *Cities Service Gas Co.*, 30 FPC 158, July 15, 1963.

were not considered by the Commission when it issued its Opinion No. 424 and order or which, having now been considered, warrant any change in or modification of said Opinion and Order.

(2) The petition by Florida Gas to reopen the record to receive the affidavits should be denied.

The Commission orders:

(A) The applications for rehearing filed by Florida Gas and the Florida Commission are hereby denied.

(B) The petition to reopen filed by Florida Gas is hereby denied.

By the Commission. Commissioners O'Connor and Woodward dissenting filed separate statements appended hereto.

(SEAL)

JOSEPH H. GUTRIDE
Secretary

This matter was decided prior to the death of Commissioner Woodward.

Appendix F—Opinion No. 431-A of Federal Power Commission

Florida Gas Transmission Company Docket No. RP61-3

Coastal Transmission Corporation Docket No. RP61-4

(Issued August 5, 1964)

O'CONNOR, Commissioner, *dissenting*:

In my dissenting statement to Opinion No. 431, I strenuously contended that a Commission which neither timely nor definitely disposed of a significant, appropriately raised issue, violated not only the specific terms of the Natural Gas Act, but also a moral obligation to the industry and the investing public.

Three affidavits have recently been filed by the still-living members of the 1956 Commission. All three, which I consider as though introduced in evidence before the Presiding Examiner, verify that the no-profits rule was raised and considered during the certification deliberations. All three indicate that the Commission was cognizant of the possible consequences of its invocation. Two of them recognize the obligation of specificity, which then-Commissioner Kline characterizes as a " . . . duty as a member of the Commission to protect the interests of all groups, and not to approve a certificate if such action might lead to entrapment of future investors."[1]

Because of these affidavits, I appreciate more clearly the prominence the no-profits issue attained during the Houston Texas certification proceedings. Consequently, I am

[1] Affidavit of Arthur Kline, filed in Application for Rehearing of Opinion No. 431, filed by the Florida Gas Company.

even more convinced that the then-Commission was derelict in its failure to clearly dispose of that issue, and that this Commission is estopped to dispose of it now. The recent 5th Circuit reversal in *Hill* v. *FPC*,[2] which admonished the Commission for declining "to undergo the judicial travail of weighing [a record] on which complete information was furnished," reinforces my convictions.[3]

A point made by Florida Gas indicates the financial severity flowing from the majority's decision. Eliminating costs from a utility's Plant Account reduces not only its gross return, but, for purposes of accounting under the Uniform System of Accounts, its annual credit to Reserve for Depreciation. In calculating its net income for tax purposes, however, the plant account elimination will not be made, although the elimination will be indicated by a reduced return. This results in an actual tax liability, assuming the current corporate tax rate of 50%, that is lower by 50% of the difference between the two depreciation figures.[4]

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[2] F. 2d (July 23, 1964).

[3] The Commission will be squarely faced with this travail in the *Natural Gas Pipeline Company of America* proceedings, Docket No. CP62-243, where the Staff, contrary to its position in G-9262, is requesting a ruling on the affiliation question contemporaneous with certification.

[4] Thus, where prior to elimination the gross income was $100 and the sole expense a depreciation figure of $50, the books, for both federal income tax purposes and Uniform System of Accounts purposes, would indicate a tax liability of $25. Assuming elimination from plant decreased gross income to $90, the depreciation charge for tax purposes would remain at $50, but would decrease for purposes of accounting under the Uniform System of Accounts. Assuming a decrease to $40, the tax liability for accounting purposes would remain at $25, (50% of $90—$40), but the actual tax liability would be but $20 (50% of $90—$50).

Under the "actual taxes" figure, the lower—actually paid—tax charge will be included in the company's cost of service.

Thus, the net effect of the majority's decision is to preclude from recovery, through the allowance for depreciation, over $8,000,000 in plant costs; to give solely to the ratepayers the $4,000,000 benefits of a legitimate tax deduction; and to deny a return to investors of over $7,375,000.[5] The impact, obviously, falls upon the investor but for whom this concededly valuable project could never have been financed. The unfortunate investor, lulled into a regrettably false sense of security by regulatory inaction, now finds himself entrapped through no fault of his own.

This outcome is onerous when one considers that the excluded costs were not fictitious or watered, but were eminently reasonable. It is particularly onerous when one considers that their exclusion results from applying a rule, born out of the early abuses of the electric power industry, which was neither designed for, nor necessitated by, the historical development of the natural gas industry.

Three other points have appeared in both the majority's basic opinion and their order denying rehearing which require comment.

The first involves the majority's desperate attempt to attribute some meaning to the troublesome language in Opinion No. 301. In so doing, they engage in a bit of contorted interpretation. The language, to them, says that the engineering and construction profits are includable for

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[5] This figure is the 30 year return at 6¼% assuming a depreciation rate of 3⅓% on a declining rate base.

testing the economic feasibility of Houston Texas, but that they are potentially excludable in any subsequent rate-making or accounting proceeding. Assuming this was the language's *raison d'etre,* one legitimately wonders how a meaningful feasibility determination can be made when the rate base—upon which dollars of return are dependent—remains subject to sizable dimunition. Particularly is this true when the basis for dimunition is readily visible at the time of certification.

The second point lies in the majority's embarrassing inability to decide who is affiliated to what. Are the engineering and construction companies collectively affiliated to Houston Texas, or severally affiliated? Only through collective association does their conclusion of affiliation have even remote validity, for no individual company was sufficiently influential to direct the policies of Houston Texas by itself. The obvious problem with a theory of collective affiliation, however, is the absence of an agreement, either explicit or implicit, to act as a collective entity, or of any evidence that they even so considered themselves. Consequently, the majority hinges their decision on an individually-affiliated theory, even though—by twenty-eight year old standards—this requires finding that *each* company had the power to direct the policies of Houston Texas. The majority tries to obscure their difficulties with this position by referring to the individual companies as a "group". This is a nifty nametag, but as a smokescreen, it shields little.

The third point lies in their repeated insistence that the Mack interests, up until 1958, the date the final contracts

were executed, continued to be completely dependent upon the construction and engineering companies. I doubt this to be true. Prior to 1956, these companies conferred a great benefit upon J. O. Mack: they stayed with him when others, feeling the project would never be certificated and thus the large expenses attributable to preliminary studies never recovered, refused to commit themselves. Prior to certification, the withdrawal of any one of the companies may well have quashed the entire project. In 1956, however, Houston Texas received its certificate of public convenience and necessity. From this date forward, a different picture was presented. Had any of the companies then decided to withdraw, the Mack interests would have had little difficulty in finding others: outside financing had been negotiated, federal sanction had been acquired, and thus recoupment of expenses—plus a reasonable profit—was the likely result for any company offered the role. The control, which may have existed either collectively or severally in the original companies in the pre-certificate days, doubtlessly did not carry over to the post-certificate days. Any assertion to the contrary does not recognize the practicalities of the industry.

For reasons expressed in my original statement to Opinion 431, and supplemented here, I dissent to this opinion and order denying rehearing. Although I remain convinced that the reasonableness of the questioned costs has been proven, in order to perfect the record, I would remand this issue for further consideration.

/s/ L. J. O'Connor, Jr.
L. J. O'Connor, Jr.
Commissioner

Appendix F—Opinion No. 431-A of Federal Power Commission

Florida Gas Transmission Company Docket No. RP61-3

Coastal Transmission Corporation Docket No. RP61-4

(Issued August 5, 1964)

WOODWARD, Commissioner, *dissenting*:

When Opinion 431 issued,[1] I dissented on the issue pertaining to consolidated taxes.[2] The Petitions for Rehearing of that Opinion and Order[3] have compelled further analysis and, for reasons hereinafter, stated, I must now respectfully dissent to the Opinion and Order Denying Rehearing.

The elimination of profits is barred by res judicata and estoppel, as well as by equity. While the limits of these doctrines in the field of administrative law is the subject of controversy, Davis sees an increasing tendency to apply them in order to do equity.[4]

The issue in the original cost case involved a determination of the proper amounts to be recorded by Houston Texas in its plant account as the actual legitimate original cost of its facilities which were constructed in 1958 and

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[1] Opinion No. 431, Opinion and Order on Accounting For Construction Profits and Consolidated Tax, Adopting Examiner's Decision With Modification, issued June 8, 1964.

[2] See dissenting statement accompanying Opinion No. 396, issued July 15, 1963 in Cities Service Gas Company, Docket No. G-18799, 29 FPC —.

[3] Application of Florida Gas Transmission Company for Rehearing of Opinion 431 and accompanying order issued June 8, 1964 and Petition to Reopen and argument in support thereof.

Petition of Intervenor Florida Public Utilities Commission for Rehearing of Opinion No. 431 and accompanying order.

[4] Davis, *Administrative Law*, § 17.09, 18.02 and supplements.

1959, pursuant to the authorization of this Commission issued in December, 1956, in its Opinion and Order No. 301.[5]

In that Opinion, the Commission unequivocally stated that while "the cost of the proposed facilities appears to be reasonable—this cost will be carefully scrutinized in any future proceeding dealing with accounting or rates . . ." The words used are plain and unambiguous; they have commonly and universally accepted meanings. The costs involved included allowances for *profits and fees*[6] and they were subject to full disclosure to the Commission in the initial certificate proceeding. This fact is uncontroverted in the record.

The Commission raised no objection to the cost evidence nor did it find any disqualifying inadequacy as to the correctness of the plant accounts submitted by the applicant. Significantly, however, our predecessors did find it necessary to impose several conditions in the certificate *relating to other matters.*

In short, "cost" cannot now be held to mean only cost less profits any more than "scrutiny" of those costs can be held to be synonomous with exclusion of reasonable profits. The word "cost" referred to the pipeline's cost since the Commission never discussed the contractor's cost.

The profits in issue arose solely from construction and engineering services rather than stock ownership and al-

[5] Opinion No. 301 (16 FPC 118), issued December 28, 1956.

[6] Emphasis supplied throughout this statement unless otherwise indicated.

lowance of the total costs, admittedly, would result in no higher costs to be recovered from consumers than would be recovered had other independent contractors constructed the pipeline. On its face, such a result is not derogatory of the public interest and this fact cannot be ignored or deemed irrelevant; it is the core of the responsibility which Congress has committed to the custody of this Commission.

Here, there was no write-up of rate base through inter-affiliate sales; there was no artificial inflation of rate base through a write-up of assets in a pooling-of-interest transaction. Nothing evil or secretive transpired. Houston Texas contracted for its work with well-established concerns experienced in the business, not on a cost-plus-a-fee basis which would guarantee the contractors a profit, but on the basis of a fixed price per unit of work, placing all risk of loss on the contractor. The evidence tendered to substantiate these facts is complete and convincing and it proves that there has been no inflation of the rate base. Absent a showing of misrepresentation, concealment or fraud, the Commission has no reason to seek now to employ a concept entirely different from that provided in Opinion 301. There has been no such showing.

There is another, perhaps decisive issue in this proceeding—the disallowance of amounts of construction costs now recorded in the plant accounts of Houston Texas would constitute a modification of the original certificate since that certificate, in effect, permitted payment of "reasonable" costs.

Appendix F—Opinion No. 431-A of Federal Power Commission

Under the facts and circumstances before us, we do not possess authority to achieve such a result any more than did the Interstate Commerce Commission in *United States* v. *Seatrain Lines,* 329 U.S. 424. There the Court held that the Commission, under the Interstate Commerce Act, could not limit a certificate once it had been issued. Similarly, there is no provision in the Natural Gas Act for modification or revocation of a certificate, partial or otherwise.

The entire amount of engineering and construction costs, including profits, should be allowed if they were reasonable and compared favorably with similar construction costs to other companies. Failure to admit evidence to this effect precludes a proper determination by the Commission of the original cost issue in this proceeding. The matter should be remanded to the Examiner with instructions to admit evidence as to reasonableness of cost, and to submit further findings and conclusions to the Commission for consideration.

Rehearing should be granted and Opinion and Order No. 431 should be reversed and set aside.

HAROLD C. WOODWARD
Harold C. Woodward

APPENDIX G

Opinion No. 431-B of Federal Power Commission

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Joseph C. Swidler, Chairman; L. J. O'Connor, Jr., Charles R. Ross, and David S. Black.

Florida Gas Transmission Company Docket No. RP61-3

Coastal Transmission Corporation Docket No. RP61-4

OPINION No. 431-B

OPINION AND ORDER DENYING REHEARING WITH RESFECT TO REOPENING RECORD

(Issued October 2, 1964)

SWIDLER, Chairman:

On September 3, 1964, Florida Gas Transmission Company filed an application for rehearing of our Opinion No. 431-A and order issued August 5, 1964, insofar as the Opinion and order relate to the petition of Florida Gas to reopen these proceedings. In our Opinion No. 431-A and order we denied rehearing with respect to our original Opinion No. 431 and order issued June 8, 1964, in which among other things we disallowed as the cost of Florida Gas' pipeline the amount of $8,187,110 representing profits of affiliated engineering and construction companies. We also denied Florida Gas' petition to reopen the record upon

the basis of attached affidavits from three former members of this Commission generally to the effect that Opinion No. 301 (16 FPC 118) granting Florida Gas' predecessor, Houston Texas Gas & Oil Corporation, a certificate did not contemplate application of the no-profits-to-affiliates rule but merely a scrutiny of the costs as to their reasonableness.

In the present application for rehearing Florida Gas renews its request that we reopen the record pointing out that the object of the Petition to Reopen was not to have the affidavits received in the record, but to have the testimony of these persons received.

Our objection to consideration of the statements of the former Commissioners in Opinion No. 431-A went not to the fact that they were by way of affidavits, rather than testimony which could be the subject of cross examination, but to the propriety of attempting to go behind the language of an opinion to determine on the basis of the recollection of former Commissioners, what they intended to decide. We do not think the issue is anyway changed by the suggestion that the Commissioners' testimony, if permitted to be introduced into evidence, would cover the question of what issue they believed was before them for decision as well as how they thought they were resolving it.

The extrinsic facts are that in the course of the proceeding in Docket No. G-9262 leading to Opinion No. 301, an intervener, Green Fuels, Inc., raised the question of whether the non-profits-to-affiliates rule should not be applied to petitioner in view of the relationship between

that company and the construction-engineering group which had been disclosed, and the matter was discussed pro and con in the briefs of some of the other interveners and the applicant. However, the Commission in its discussion did not mention the no-profits-to-affiliates rule or in terms adopt or reject the intervener's contentions. Instead it confined itself to the statement:

> . . . While as we have already stated, the cost of the proposed facilities appears to be reasonable, in view of this fact [that three companies who would perform construction activities for the pipeline had presidents who were each officials and directors of Houston Gas, and two of which owned blocks of Houston Gas stock], this cost will be carefully scrutinized in any future proceeding dealing with accounting or rates of Houston Gas. (16 FPC 142)

It is of course possible that the Commission in deciding the matter, and the three Commissioners in the majority, in subscribing to the above statement, intended to hold that the intervener was wrong and the applicant right as to the application of the no-profits-to-affiliates rule, and that "in any future proceeding dealing with accounting or rates of Houston Gas" the careful scrutiny to be given to proposed construction costs would be limited to their reasonableness. This is not, however, what was said. The intervener, who had raised the matter in the first place, clearly was not put on notice by the language the Commission utilized that, if he did not seek rehearing on this point and then raise it on review, there would be a final adjudication outstanding against him on this issue. More impor-

tant, there was nothing in this vague language which could properly have led Houston Texas to the conclusion that the Commission had necessarily resolved the question in its favor rather than deferring it for subsequent consideration on an appropriate record devoted expressly to the issue. Thus, even assuming that the Commission intended to resolve the issue in petitioner's favor, testimony to that effect today could not change the fact that they did not do so. The time for petitioner to have sought clarification from the Commissioners as to the intent of their language was when the matter was still pending before the agency, not years later during the course of the subsequent proceeding the Commission's language pre-shadowed.

It devolved upon this Commission to interpret the vague language quoted above. In carrying out this ordinary duty of any judicial body to interpret its prior opinions, we think it would be highly improper to consider affidavits from former Commissioners as to what was before them or what was decided by them, and even more improper to call them as witnesses. We are here dealing with the opinion of a quasi-judicial body. Courts and commissions speak only in their opinions. To depart from this traditional rule would remove any assurance as to the significance to be attached to written opinions, and would make the meaning of our decisions depend on subjective impressions and the vagaries of memory.

The distinction which petitioners attempt to make between what an opinion means and what issues it covers is without substance. The issues decided by an opinion (as well as how they are decided) can be determined only from

the opinion itself. In our judgment it is clear that the prior opinion in this case did not decide the issue whether the no-profits-to-affiliates rule should be applied in determining the original cost of this pipeline.

The Commission further finds:

The assignments of error and grounds for rehearing set forth in the application for rehearing of Florida Gas present no new facts or principles of law with respect to reopening the record to receive the testimony of three former members of this Commission which were not considered by the Commission when it issued its Opinion No. 431-A and order or which, having now been considered, warrant any change in or modification of said Opinion and order except as indicated below with respect to receipt of testimony rather than affidavits.

The Commission orders:

(A) The application for rehearing filed by Florida Gas with respect to Opinion No. 431-A and order is hereby denied.

(B) The petition to reopen the record to receive the testimony of three former members of the Commission is hereby denied.

By the Commission.

(SEAL)

JOSEPH H. GUTRIDE
Secretary